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TOYOTA'S WRONG TURN | BULL MARKET BELIEVERS

Bloomberg BusinessWeek

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*ISAAA Brief 39: *Global Status of Commercialized Biotech/GM Crops 2008*

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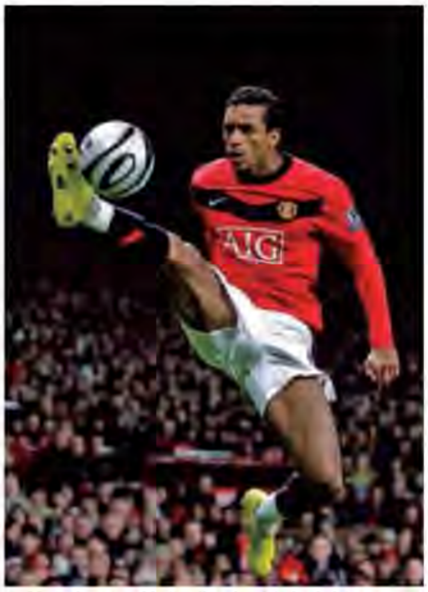
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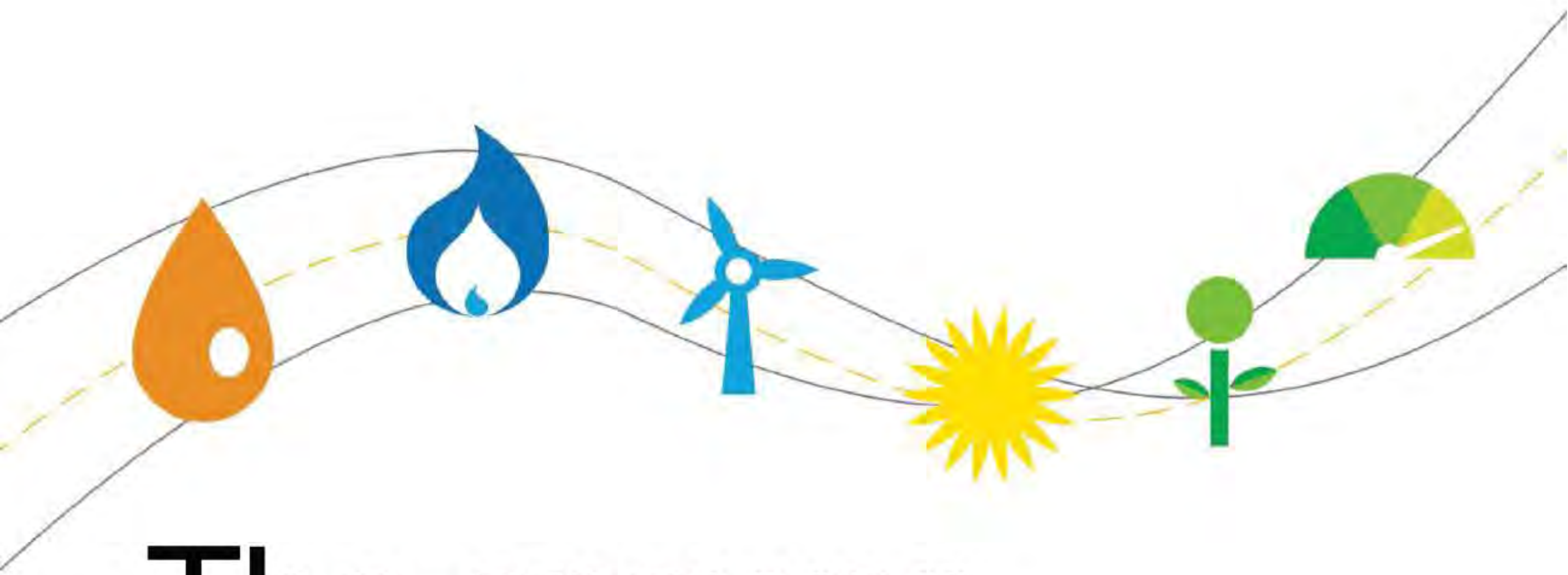
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THE WEEK IN BUSINESS

ECONOMICS & POLICY

FINANCIAL REFORM

Federal Reserve Chairman Ben Bernanke can claim at least one victory: The central bank's emergency, short-term lending operations have been so successful in stabilizing the financial system that they're no longer necessary. On Mar. 8 the Fed quietly conducted the last auction of $25 billion worth of one-month loans under the two-year-old **Term Auction Facility.** It attracted bids for only $3 billion, a sign that the emergency has waned. While the banking system may be stabilizing, the economy remains weak. On Mar. 5 the **Labor Dept.** said that nonfarm payrolls fell by 36,000 in February, with the unemployment rate staying steady at 9.7%. For the Fed, that means it's still too soon to take the next step and raise interest rates. For investors, the message is more ambiguous. Will economic weakness restrain stocks, or is the bull just catching its breath?

|BW| PAGE 66 "Bull Market Believers"

A FUND FOR EUROPE?

Debt-ridden Greece promises it won't default, but the **European Union** isn't taking any chances. On Mar. 8 the EU announced plans to create a European Monetary Fund to bail out countries whose finances are in disrepair. Officials said any cash would be contingent on nations reining in debt and ratcheting up revenues. **German Chancellor Angela Merkel** backed the plan, though EU central bankers cautioned that the fund could disincent countries from cleaning up their books of their own accord. During a meeting with **U.S. President Barack Obama** on Mar. 9, **Greek Prime Minister George Papandreou** called for a clampdown on financial speculators he blamed for worsening his country's situation.

|BW| PAGE 21 "Greece's Weakness Is Its Strength"

$3.51 trillion

Estimate of total assets under management by sovereign wealth funds, a 9% increase from a year ago

Data: Preqin Sovereign Wealth Fund Review

FINANCE

ADIOS, DEBIT OVERDRAFTS

Bank of America, the No. 1 U.S. bank by assets, will soon make it impossible for customers to spend more with a debit card than they have in their accounts—unless they arrange in advance for overdraft protection. That will cost the bank tens of millions of dollars in fees, said *The New York Times* on Mar. 10, though the bank declined to comment on that figure. The measures will take effect on June 19 for new accounts and in August for existing ones. BofA's move will also pressure rivals to take similar action before July 1, when new Fed rules require that they do so.

RECORD BREAKING

Unemployment hit new highs in several states in January

PERCENTAGE OF LABOR FORCE	
South Carolina	12.6
California	12.5
District of Columbia	12.0
Florida	11.9
North Carolina	11.1
Georgia	10.4

Data: Bureau of Labor Statistics

STRATEGY

ANOTHER DEAL FOR AIG

American International Group took one more step toward getting out of hock to the federal government, agreeing on Mar. 8 to sell its **American Life Insurance** unit to **MetLife** for $15.5 billion. Along with its Mar. 1 deal to sell its Asian life insurance operations for $35.5 billion to Britain's **Prudential,** the transactions will generate $31.5 billion in cash repayments for the **Federal Reserve Bank of New York,** which saved the firm from bankruptcy in September 2008. An additional $19.2 billion will be paid in securities that AIG will liquidate to cut its debt to the bank. Presuming the value of those securities holds steady, AIG would still owe $44 billion



Bernanke's Fed held its last auction of one-month loans. Demand was low

CHRIS RANK/CORBIS

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EXECUTIVE SUMMARY



An artist's rendering of Northrop's proposed tanker, now defunct

to the government. The company's bonds have been on a tear thanks to reduced worries about its obligations, and AIG stock rose 29% on this week's news, to close at 36.24 on Mar. 10. A year ago it sold for 8.40.

NORTHROP GIVES UP

After a decade-long dogfight, **Boeing** looks set to grab a $35 billion **U.S. Air Force** refueling tanker contract after its only rival—**Northrop Grumman** and its partner **European Aeronautic Defence & Space**—dropped out. Northrop withdrew on Mar. 8, saying Pentagon specs "clearly" favored Boeing's plane. The announcement, which leaves no competition for one of the biggest defense contracts in history, sparked a protest from the **European Union's** trade chief, **Karel De Gucht,** who called the situation "highly regrettable." The tanker specs were rewritten after Boeing protested a 2008 decision to give the contract to Northrop and EADS. Losing it will rock EADS, which is struggling with cost overruns on its **A400M** military transport plane in Europe. On Mar. 9, EADS posted a $1.04 billion full-year loss after taking a $2.45 billion charge on the A400M.

PRIUS PROBLEMS

Has **Toyota** really repaired its acceleration flaws? Twice last week, motorists claimed their

CORRECTIONS & CLARIFICATIONS

"A High-End Bet on Nuclear Power" (In Depth, Mar. 15) said China plans to buy four nuclear reactors from Westinghouse. China has already signed contracts for the purchase. The story also said the expected startup date for a new reactor at Calvert Cliffs, Md., is 2015. It is 2017.

IDEAS STIMULUS SPENDING: HOW TO GET MORE BANG FOR THE BUCK

Economists just can't agree about the Obama Administration's stimulus program. Some argue that the $787 billion spending push, much of it devoted to infrastructure projects, paved the way for an economic recovery. Others hold that at best it had little effect and at worst was detrimental.

A recent working paper from the **National Bureau of Economic Research** in Cambridge, Mass., titled "On the Ease of Overstating the Fiscal Stimulus in the U.S., 2008-9," provides more grist for the controversy mill. In it a pair of economists argue that when you examine the increase in federal spending in 2009 and adjust it for the decline in fiscal expenditures of the 50 states, the net effect is close to zero.

The authors of the paper, **Joshua Aizenman** of the **University of California at Santa Cruz** and **Gurnain Kaur Pasricha** of the **Bank of Canada**, don't go as far as to label the stimulus a failure. They concede that it would be difficult to project how the U.S. economy would have performed in the absence of ramped-up federal spending. Their goal is to arrive at a better understanding of how fiscal policy can be made to work more effectively. Federal transfers to the states might yield a bigger bang for the buck, the authors suggest.

However, this must be done in a way that mitigates "moral hazard"—that is, Washington should not reward states for imprudent behavior such as excessive borrowing. One option would be to channel funds to states on a per capita basis, suggest Aizenman and Pasricha. State governments would also have to commit to spend the funds and not use them to repay debts.



Highway work in Florida: Much of the $787 billion stimulus went to infrastructure

⊵ National Bureau of Economic Research

(FROM TOP) NORTHROP GRUMMAN; JOE RAEDLE/GETTY IMAGES



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EXECUTIVE SUMMARY

Prius hybrids unexpectedly sped up. The first was a driver in San Diego who said his 2008 Prius revved out of control on the highway. The second complaint came from a woman in Westchester County, N.Y., who smashed into a concrete wall. Toyota has already recalled the 2004 through 2009 Prius for floor mat problems. The **National Highway Traffic Safety Administration** is looking into the latest incidents. Meanwhile, the carmaker disputed claims from **Southern Illinois University** professor **David Gilbert,** aired on **ABC**, that electronics are to blame for the sudden surges. Gilbert testified before a House panel on Feb. 23 that he found weaknesses in Toyota's throttle system. The company said his attempts to replicate unintended acceleration bore little resemblance to actual conditions.

| BW | PAGE 32 **"The Humbling of Toyota"**



Priuses at Toyota City: Two acceleration incidents raised new alarms

SHELL'S AUSSIE BID

Royal Dutch Shell is covering two strategic bases with its $3.4 billion bid for Australia's **Arrow Energy.** The primary goal of the acquisition is to increase its natural gas supplies—Shell is a leader in the global boom in liquefied natural gas, and Arrow has the largest plot of coal-seam methane gas down under—25,000 square miles. Shell also hopes to reinforce its prospects for access to the Chinese market; the company chose state-owned **PetroChina** as its partner in the Arrow bid.

THE MOVIE THAT ROARED

Not since Hollywood started tracking box-office receipts has the **Oscar** for **Best Picture** gone to a movie with such a small take: $14.7 million. While ***The Hurt Locker's*** sheaf of awards humbled ***Avatar*** and its $2.5 billion mega-gross, the little Iraq war movie probably won't get much of a post-Oscar box-office bounce, since distributor **Summit Entertainment** has already shipped it to DVD. At least New York's TV audience could see *The Hurt Locker's* winning moment: Minutes into the **ABC** telecast, viewers serviced by **Cablevision** in Long island had their reception restored after the two settled their dispute over "retransmission" fees that ABC wanted the cable operator to pay to air shows from network affiliates.



The Hurt Locker, with a skimpy $14.7 million gross, won for Best Picture

(FROM TOP) KAZUHIRO NOGI/AFP/GETTY IMAGES; SUMMIT ENTERTAINMENT/EVERETT COLLECTION



THE OPTIMISM METER

A BRIGHTER OUTLOOK, BUT NOT ON JOBS

The Meter clocked in at 55 on Mar. 9, up from 53 a week earlier. Despite the overall increase, Americans remain decidedly bearish on U.S. employment: 46% describe the prospect of finding a new job as "very hard." Developed by ***Bloomberg BusinessWeek*** using data from pollster **YouGov**, the Meter is a proprietary measure of sentiment and expectations, economic statistics, and market forecasts. It evaluates shifts in outlook among individuals, professional investors, and economists in the areas of U.S. economic growth, jobs, equity markets, and real estate.

Calculated using consumer polling, economic forecasts, and financial markets data; 0=lowest and 100=highest Data: YouGov, *Bloomberg BusinessWeek*

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AT THE TABLE CHARLIE ROSE





(FROM TOP) BRAD TRENT; EVAN VUCCI/AP PHOTO

NANCY PELOSI
Health-Care Reform Endgame

In the past year, Speaker Nancy Pelosi has pushed a $787 billion stimulus package, a $154 billion jobs program, and funding for the wars in Iraq and Afghanistan through the House. Now her ability to marshal Democratic votes makes her the central player in the most important drama in Washington: the possible passage of health-care reform legislation. What follows are edited excerpts from a conversation aired on Mar. 10.

CHARLIE ROSE
Many say health reform is on your shoulders; it depends on your ability to convince Democrats. You've got the President campaigning like crazy, but you have to deliver the votes.

SPEAKER NANCY PELOSI
Well, I take responsibility for whatever the outcome is, but we're at a place now where I think reform is definitely within reach.

Do you have the votes at this moment?
We don't have the bill yet.

Would you be in a better place if the President started doing what he is doing now—out there speaking with the passion he had during the campaign—a year ago?
One year ago on Mar. 5, President Obama called Democrats and Republicans from the House and Senate to the East Room of the White House. In that room he had all of the stakeholders—children's health, public hospitals, private caregivers, insurance companies, the pharmaceutical industry, you name it, every stakeholder in health

insurance reform was represented. On that very day—only about five to six weeks after his inauguration—the President began to reach out to the Republicans. It was important to him to strive for bipartisanship, and in fact the health-care bill we will pass has over 150 Republican amendments. It may not have a bipartisan vote, but it has bipartisan amendments.


Hard sell: Obama campaigning near Philadelphia for his health-care plan on Mar. 8

The rise in health-care premiums in California seems to have set him off.
It certainly did. That [Anthem Blue Cross] increase in California—39%—lit the flame, and that's only one example of the outrageous increases and irresponsibility of insurance companies. What emerged from the recent health-care summit is that Democrats want to regulate the insurance companies; Republicans do not. Left to their own devices, the insurance companies have done harm to the economic well-being of the American people.

Didn't all the talk about a public option hurt the possibility of health-care reform?

THE INSURANCE COMPANIES HAVE DONE HARM TO THE ECONOMIC WELL-BEING OF THE AMERICAN PEOPLE

Well, I myself was a very strong supporter, but yes. If you are an insurance company, you want to take down the public option, right? You want to get rid of that. But as you do it, you want to confuse the issue of health-care reform. As long as people are talking about the public option, they are not talking about what is in the bill for the American people. But you know what? In some ways it's water under the bridge. It's unfortunate because I think if we had a bill much sooner, all of its merits would be better known, and it would not have been a piñata for six months.

When history is written about health-care reform in the first year of the Obama Administration, it is said by many people that we will find out the Speaker was telling the President he was wasting his time trying to get Republican participation.
Hmm, really? Who said that?

Two Nobel laureate economists—Paul Krugman and Joe Stiglitz—are saying the stimulus wasn't big enough and it didn't create enough jobs quickly.
Obviously the package was bigger in the House, but the President wanted bipartisanship so we got a smaller package coming out of the Senate. But having said that, it was an excellent initiative. And I think it's important to note the following: The health-care bill is a job creator. It will create 4 million jobs over the life of the bill, and several hundred thousand very soon.

How long will it take you to create enough jobs to get back to an unemployment rate that's at 6%?
Well, it will take some time .

Four or five years, right?
Do I have to remind you of the mess President Obama inherited from President Bush, who refused to make these investments in America's infrastructure and job creation?

What do you think unemployment will look like by the end of this year?
Well, it will look a lot better than it would have if we hadn't passed the recovery package.

O.K., but that doesn't answer the question. What will it look like? Will it be at 8%, 9%?
I can't predict that. But everybody is telling us the unemployment rate would be two points higher now if we had not passed the recovery bill.

Obama Chief of Staff Rahm Emanuel is at the center of a controversy over the effectiveness of the Administration. People pointing the finger at him; columns being written. What happened? You know this town.
I know this town, and it's an archery range. Rahm is effective. When you're effective, you become the target. |BW|

Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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NUMBERS

THE BENEFITS—AND COSTS—OF COLLEGE

By Tara Kalwarski/Charts by Stanford Kay

College tuition and fees are up 92% since 2000. Is it worth the cost? Highly educated workers earn more, though pay raises have barely kept up with inflation. They have more job security, too.

Salary Edge: Advanced-degree holders earn triple what high school grads make. But nobody has been getting big raises.



*Calculated by taking the annual average weekly earnings of full-time wage and salary workers age 25 and over, and multiplying by 52 **Includes master's, professional, and doctoral degrees
Data: Bureau of Labor Statistics

Employability: The more educated you are, the less likely you are to be out of work.

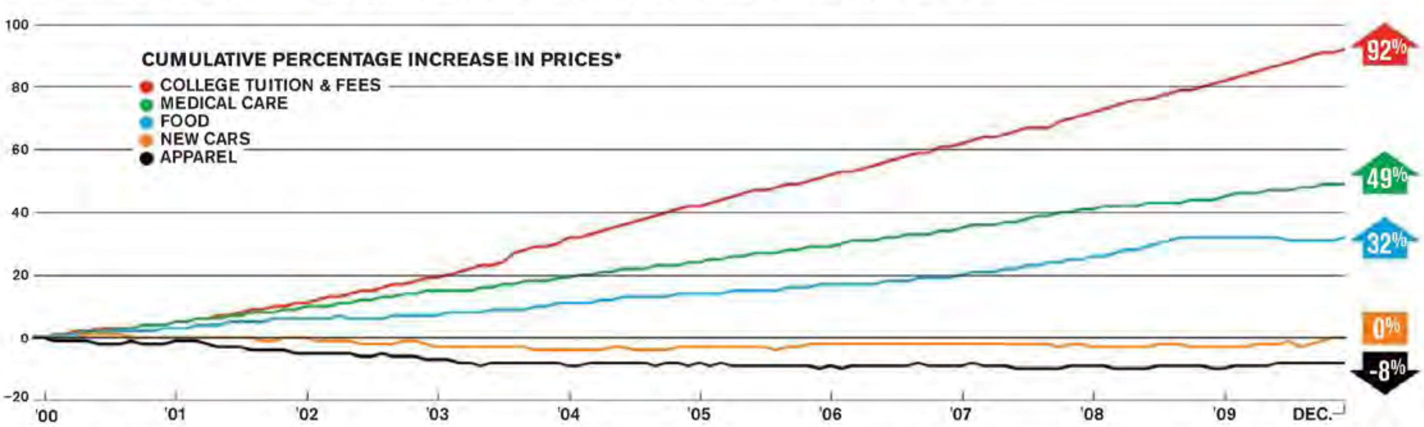
Unemployment rates by level of education*

5.0%	Bachelor's degree and higher
8.0%	Some college or associate's degree
10.5%	High school diploma, no college
15.6%	Less than a high school diploma

*As of February 2010; seasonally adjusted
Data: Bureau of Labor Statistics

A SMALL PRICE TO PAY?

Inflation in higher education expenses has been nearly double that of medical care.



*Seasonally adjusted

Data: Bureau of Labor Statistics, American Institute for Economic Research

DO YOU AGREE OR DISAGREE?

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Poor math and science education in the U.S. will lead to higher unemployment.

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BUSINESS OUTLOOK | RICH MILLER

'THE NEW NORMAL' VS. 'THE NEW MIX'

The difference between terms is more than just semantics. One forecasts prolonged drudgery, the other sees recovery. So which should be on the tip of your tongue?

It was just about a year ago that Mohamed El-Erian and his colleagues at Pacific Investment Management Co. coined the phrase "the new normal" to describe their vision of America's economic future. The chief executive of the world's largest bond fund argued that retrenchment by debt-laden consumers and tougher regulation of the financial-services industry would leave the U.S. with tepid annual growth of around 2% for years.

Now, economists of a more optimistic bent have come up with a phrase of their own to describe the outlook: "the new mix." Originated by Joseph Carson, an economist with AllianceBernstein in New York, this model posits an economy powered more by exports and business investment than by the traditional drivers of consumption and housing. This shifting mix of demand will boost the economy by 3.7% this year and pave the way for average annual growth exceeding 3% thereafter, predicts Carson.

18.2%

Increase in business spending on equipment and software in the fourth quarter of 2009

Data: Bureau of Economic Analysis

It matters a lot which group ends up being right. El-Erian warns that stock prices may already have risen too far based on his economic forecast and predicts that the Federal Reserve will keep interest rates near zero through 2010. Carson, however, sees the central bank raising rates to 2% by yearend as the economy strengthens. His former colleague at Deutsche Bank Securities, Joseph LaVorgna, predicts that the Standard & Poor's 500-stock index will climb to 1,325 by Dec. 31, from 1140 on Mar. 9, as the new mix gooses the economy and corporate earnings.

Advocates of both camps agree consumption will be held back as households struggle with a 9.7% unemployment rate and the $12.6 trillion plunge in their net worth during the Great Recession. They also agree that emerging markets, not the U.S., will lead the world economy in the recovery. Where they differ is on the extent that U.S. companies can tap into the expansion overseas, boosting American growth in the process.

Carson believes the U.S. is well positioned to take advantage of the recovery abroad because, in recent years, U.S. manufacturers have significantly boosted their productivity, enhancing their competitiveness in world markets. Output per hour worked in manufacturing rose at an annualized rate of 6.6% in the fourth quarter after climbing 14.8% in the third, the most on record. That's because factories cut workers even as demand rebounded. The weaker dollar also helps the U.S. fight for global market share. The greenback is down about 12% against six major currencies since 2006, despite its recent rise vs. the euro due to Greece's budget woes.

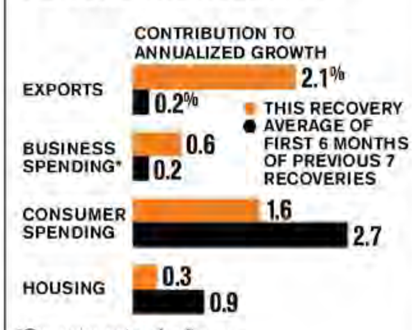
Declaring that the U.S. can no longer depend on the bubble-driven expansions of the past, President Barack Obama is doing his part to promote the new-mix paradigm. He wants to increase government-backed export financing for small businesses by 50%, to $6 billion a year, and he devoted more than $90 billion of last year's stimulus package toward promoting investment in alternative energy.

The performance of the economy since hitting bottom in the middle of last year buttresses the arguments of the optimists. Growth in 2009's second half was stronger than the new-normal camp had expected, with the economy expanding at an annual clip of 5.9% in the fourth quarter, its fastest pace since 2003.

More important, exports and business spending on equipment and software are providing more oomph in this upturn than in past recoveries (chart), while consumption and housing are contributing less. Manufacturers are even doing some hiring. Factory payrolls rose 1,000 last month after increasing by 20,000 in January, the first back-to-back gain since 2006.

The new-normal proponents aren't yielding ground. They argue that much of the economy's late-2009 vigor came from temporary factors such as fiscal stimulus and inventory rebuilding, and that growth will slow to an annual rate of around 2% by yearend. That may well be. But Round One in the battle of outlooks goes to the new mix-ers. |BW|

THIS TIME, BUSINESS POWERS THE RECOVERY



*On equipment and software

Data: Bureau of Economic Analysis, National Bureau of Economic Research, Bloomberg calculations

CHART BY STANFORD KAY

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NEW BUSINESS



JOHN MACDOUGALL/AFP/GETTY IMAGES

Greece's Weakness Is Its Strength

Prime Minister Papandreou has used his country's fragile state to his advantage in negotiations with the EU

By Peter Coy

If you want to learn how to dig yourself out of a deep hole, watch Greek Prime Minister George Papandreou. The 57-year-old socialist is urgently seeking some kind of financial backstop from other European governments while trying to placate farmers, labor unions, and civil servants on the one hand and jittery foreign investors on the other. As the son and grandson of past Prime Ministers, Papandreou is the closest thing to royalty in a country that abolished its monarchy in 1974. Yet his regal air hasn't been the least bit compromised by the fragility of Greek finances. His serenity comes from a shrewd understanding of the principles of negotiation: Greece's very weakness lends it strength, because when your back is already to the wall, you can't be pushed any further.

Papandreou and Merkel can both benefit by vilifying "unprincipled speculators"

Every televised riot and bonfire in Athens strengthens Papandreou's argument that Greece can't handle any more austerity without a breakdown of society. As a result, other European nations that fear a Greek default have concluded that they must take more responsibility for preventing it from happening. "Papandreou has a game plan," says Simon Johnson, an economist at Massachusetts Institute of Technology who observed his share



Papandreou has hinted he might seek IMF help, something the EU wants to avoid

of gamesmanship as a former chief economist of the International Monetary Fund. "He is doing this very well."

The first rule of negotiation—which Papandreou has clearly mastered—is to know the "BATNA"—or "best alternative to a negotiated agreement." If the alternatives to a negotiated settlement are good, you have no incentive to budge from your position. If the alternatives are undesirable, your motivation to cut a deal increases.

Greece has a weak BATNA. If it stops cooperating with the European Union and doesn't slash its budget deficit, it will lose the confidence of investors and most likely become unable to roll over its foreign debts. If it defaults, interest rates on any new funds it needs to raise would be sky-high, if available at all, stunting growth for years to come.

Having a weak BATNA doesn't debilitate a good negotiator, though, because the other side's alternatives are equally relevant. A default by the Greeks would cause big losses for German and French lenders and, more important, fan fears of possible defaults by Portugal or Spain. If the market value of loans to those countries fell markedly, the balance sheets of some banks in Northern Europe would be severely damaged, says MIT's Johnson.

In other words, Greece is a teetering domino that Europe desperately wants to keep upright. Harvard Law School Professor Robert H. Mnookin, chair of the school's Program on Negotiation, says Papandreou is playing the same "save us to save yourselves" card as former South Vietnamese President Nguyen Van Thieu, who extracted concessions from the U.S. during the Vietnam War by warning repeatedly that without increased U.S. help his country would fall to the Communists (which, of course, it did).

Papandreou's frequent hints that he might seek assistance from the IMF if he can't get what he needs from Europe can be seen as an attempt to make his BATNA appear stronger, says Zacharias Maniadis, a Greek economist at Bocconi University in Milan. Europe, especially Germany, wants to solve the Greek crisis without IMF interference.

Of course, in diplomacy, as in threatening to turn the car around on your squabbling kids, a gambit is only effective if it's believable. The other Europeans could call Papandreou's bluff by telling him to go ahead and ask the IMF for help. Olivier Jeanne, a French economist at Johns Hopkins University who used to work for the IMF, says the fund would not intervene in Greece without an invitation from the European Union. Even if the IMF did step in, Jeanne says it probably wouldn't offer kinder conditions than those set by the Europeans.

While Greece's economic weakness gives it an edge at the bargaining table, Papandreou can't push that advantage too hard. After all, Greece still needs to borrow. If foreign investors fear that Athens will stiff them someday by crying poor, they won't lend, says Mark L.J. Wright, a University of California, Los Angeles economist. Cautious investors insisted on a yield of about 6.4% to buy around $7 billion worth of Greek debt on Mar. 4, more than double the yield on comparable German debt. That's why Papandreou hasn't overplayed his weakness card.

There are fewer drawbacks to another Papandreou strategy, his vilification of what he calls "unprincipled speculators." He can help German Chancellor Angela Merkel sell a bailout to the German people if he can shift attention away from Greek profligacy, says MIT's Johnson. He says Merkel needs to "construct a narrative" that "we saved Greece because the evil American speculators blah blah blah...."

Game theory explains why the two sides haven't yet cut a deal despite the high costs of delay. The fact is, Germany's Merkel is no pushover. She and other European leaders know they have maximum leverage over Greece now, when they are free to bestow or withhold support. Once support is given, the leverage is lost. Eventually, though, most experts believe some kind of deal is bound to be struck simply because the costs of a Greek default would be intolerable to all parties. That explains George Papandreou's regal calm. |BW|

–With Shobhana Chandra in Washington

HOW TO PLAY A BAD HAND

Greece's economic difficulties can be an asset for Papandreou:

- Greek leaders can claim that they have gone as far as they can to shrink their deficit
- Conditions in Greece are so bad that default seems slightly less frightening by comparison
- Other European nations are more likely to give aid, fearing default is a real possibility

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Smarter business for a Smarter Planet:

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THE PAPANDREOU OFFENSIVE

The Prime Minister on the dangers of not saving Greece

On the day Prime Minister George Papandreou met with Secretary of State Hillary Clinton, House Speaker Nancy Pelosi, and President Obama, he found time to talk with Charlie Rose. Below are edited excerpts of an interview first televised on Mar. 9.

Have speculators made your job more difficult?
[It's like] taking out insurance on your neighbor's house and then if it burns down, you get the money ... but betting on failure—in this case the poor economy of Greece—makes it difficult to get normal loans so the economy can survive.

What would happen if Greece were to be another Lehman Brothers?
First of all, Greece won't go down because we're talking about a country that is capable of making change ... and Europe will not allow the destabilization of the 27-country euro zone. But if there was no action, then markets would start becoming jittery about other countries, and not only Spain and Portugal. It could be other countries in the European Union.

What impact might it have on the United States?
I don't want to be a doomsayer, and I don't want to create any problems, but this would create imbalances in the exchange rate between the euro and the dollar. I'm not an expert on these issues, but I would think what would happen is the fluctuations ... could create a further recession around the world.

Just to make sure I understand this, the message you got from Chancellor Merkel and President Sarkozy and others is that if it's necessary as a last resort for the European Union to step in, they're prepared to do that. That's the guarantee you got?
That's the guarantee we have, not only from them but from the 27 members. If push comes to shove, there will be solidarity from the European Union.

These financial instruments, which some people called innovation, were exported from the U.S. to around the world, not only to Greece. These were legitimate tools at the time. Now these legitimate tools have created problems.

You have said that Greece should not be a crisis but a case study.
That's right. I would like to see Greece as a case study, an opportunity for Europe to strengthen its coordination of fiscal policy.

So this has led to discussions about a European Monetary Fund that would be there as an emergency measure in the future.
Yes, I would say [a European Monetary Fund is] on the table.



Hellenic hath no fury: Police and protesters clash in Athens on Mar. 5

And what about the International Monetary Fund?
We never ruled out the International Monetary Fund. We hope that we won't need any of that kind of help, that the markets will respond positively to our changes. We have said we don't think this will be necessary, but we will keep that option open if we see that things don't go the way we hope they go.

Did American financial institutions help the Greek government cover up the level of its debt?
I wouldn't use the word cover up.

Larger questions are being raised about the EU by the crisis—namely, that when you stitch together disparate economies with one common currency, it doesn't work. Is the idea of one Europe dead?
The fact that we're going through a crisis is an opportunity for Europe to be more coordinated and more integrated. We're actually talking about a European Monetary Fund or euro bonds, about guarantees for countries, about economic governance in the European Union. That shows the strength of Europe. |BW|

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First, Slap Limits on Bank Leverage

The fight over a financial consumer protection agency misses the point. What fueled the crisis was bank debt

By Roger Lowenstein

Republicans and Democrats in Congress have been squabbling about whether the new financial consumer protection agency should be housed within the Federal Reserve or as part of an independent body. The watchdog, wherever it ends up, is the linchpin of the emerging financial reform bill, and its premise is that greedy bankers exploiting dumb consumers essentially caused the credit crisis. Stop bankers from selling toxic mortgages and other harmful loans, goes the theory, and we won't have any more meltdowns.

Even though bankers were greedy and many borrowers were naive, this is a simplistic way of viewing the financial crisis. Since mortgage bankers make money from loans, it's tempting to think of them as parasites who prey on customers. But there is no such thing as a smart bank with a dumb customer; if the loan turns sour, the banker was dumb, too. And in the mid-2000s, scads of them were.

Foreclosures by consumers heavily weighed on the economy, but what triggered the credit crunch was the failure (or near-failure) of the banks that issued (or acquired) the mortgages. In short, the root cause of the meltdown wasn't that customers borrowed too much; it's that banks lent too much. Before the bust, champions of the new consumer agency, such as Representative Barney Frank (D-Mass.), were consistent advocates of more loans to subprime borrowers. That's hardly surprising; it's in the nature of folks to want more credit.

This isn't to deny that many subprime loans were exploitative and that customers often didn't understand repayment terms. Nor is it a bad idea to police banks, preventing them, for instance, from charging exorbitant fees.

Yet a sound economy needs healthy financial institutions. Rather than stop lenders from hurting consumers, the aim of regulators should be to force banks to do what is in their own and society's interests: practice sound banking. No consumer watchdog can do this because systemic risk aggregates at the level of the lender. The surest solution is to limit the leverage of financial institutions. Regulators have already moved against dicey products such as no-documentation mortgages ("liar loans"), and ones in which borrowers get 100% financing. And well they should.



Frank: Before the crisis, he was an advocate of more subprime lending

But rather than try to make banks perfect, the main goal should be to minimize the damage when they prove imperfect. The way to do that is to limit leverage by restricting their use of debt. Leverage acts like an accelerator, magnifying and spreading losses from one borrower to another. In most meltdowns, this has played a leading role.

In the late 1980s, for example, companies paid silly prices for acquisitions until, in 1990, the mania stopped. Since almost every deal had been financed with boatloads of junk bonds, the crash left business saddled with debt, and banks were stuck with sinking assets. The country went into a recession.

By contrast, investment bubbles that aren't associated with debt are far less lethal. The dot-com frenzy was easily the most flagrant episode of speculation in the last 75 years. Scores of companies with zero earnings sold stock; dozens of these initial public offerings soared in value on their first day of trading.

By contrast, the recent real estate bull market was tame. Home prices doubled over five or six years—impressive, but nothing like the IPO stocks that doubled in a day. Yet when the dot-com bubble burst in 2000, the impact was modest. The country had a mild, brief recession. Unemployment topped out at 6.3%.

The mortgage bubble, on the other hand, was built brick by brick with debt. And it led to the worst recession since the Great Depression, with unemployment over 10%.

U.S. regulators have been reluctant to raise bank capital requirements without a global accord, lest American companies be put at a disadvantage. And the international Financial Stability Board in Basel, Switzerland, has been vowing to raise capital standards. However, the process is slow. Congress should make clear that if the board doesn't act, it will. There can be no going back to 30-to-1 leverage on Wall Street.

Since much leverage today is kept off the balance sheet (via derivatives), any financial reform that doesn't curb the use of such instruments is sorely flawed. Congress should immediately boost the amount of margin capital required to place derivative bets—the equivalent of reducing leverage.

Protecting consumers and breaking up large banks are fine. But neither measure will prevent banks from acting stupidly again. The surest safeguard is to ensure that, when they do, they aren't up to their necks in debt. |BW|

LARRY DOWNING/REUTERS

Give Me Your Smart, Your Motivated...

The proposed StartUp Visa Act would open the door to foreign entrepreneurs who create jobs

By Douglas MacMillan



Stevens and Tegelaar may have to return to the Netherlands this spring

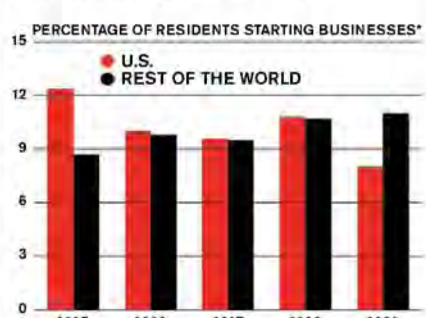
Peter Tegelaar and Coen Stevens sound like just the sort of entrepreneurs the U.S. economy could use right now. The two friends are working on a Mountain View (Calif.) startup called Newcope and want to hire employees. But there's a problem: They're Dutch. In the U.S. on tourist visas, they'll have to return to the Netherlands this spring, unless something changes fast. Jeff Clavier, a venture capitalist who is considering backing the pair, says their departure would hurt Newcope's prospects, since the company is working on a payment system for online games and much of that expertise is in Silicon Valley. "Their likelihood of success in the Netherlands is close to zero," he says.

Tegelaar, 28, and Stevens, 27, have a chance for a reprieve. With prodding from the U.S. venture community, Senators John Kerry (D-Mass.) and Richard Lugar (R-Ind.) have proposed a two-year visa for any immigrant entrepreneur who can secure $250,000 in capital from American investors. After the two years are up, the person could become a permanent resident if his or her business has created five full-time jobs in the U.S., raised an additional $1 million, or hit $1 million in revenue. The senators hope to pass the StartUp Visa Act this month as part of legislation aimed at helping small businesses add jobs. "This bill is a small down payment on a cure to global competitiveness," wrote Kerry in an e-mail to *Bloomberg BusinessWeek*.

The startup culture in the U.S. has long been the envy of the world, but other countries are closing the gap. Last year 8% of U.S. residents founded companies, down from 12.4% in 2005, says the Global Entrepreneurship Monitor, a research consortium of the London Business School and Babson College. In 53 other countries that the group tracks, the percentage of residents creating companies rose to an average 11%, from an average 8.7%, over the same stretch. "The incentive for entrepreneurs to bring their ideas to the U.S. would be the prospect of becoming a resident of this country and the potential for a greater market," said Lugar in an interview.

STARTUP SLOWDOWN

The U.S. has lost its lead in creating businesses, by one measure



*Includes businesses launched in the prior 42 months or planned for the next three months

Data: Global Entrepreneurship Monitor

The idea for the bill began with Paul Graham, a partner at the Mountain View startup incubator Y Combinator, who wrote an online essay in April arguing for what he called a "founder visa." The post prompted Foundry Group Managing Director Brad Feld, Founders Fund investor Dave McClure, and other venture types to push the idea in Washington. More than 160 venture capitalists and other investors signed a statement backing the bill. "It's such an obvious win," says Graham. "The smartest and most ambitious people [could] come to Silicon Valley."

The proposal is one of the few with bipartisan support in Washington. Still, passage isn't a sure bet. One matter of debate is how much the U.S. would benefit from the proposed visa. Proponents say it could attract thousands of startups in a few years and tens of thousands of jobs. Ron Hira, associate professor of public policy at the Rochester Institute of Technology, counters that the legislation's backers haven't done enough research to support such optimistic projections.

As for Newcope, Tegelaar and Stevens are spending what may be their last weeks in the U.S. going to the Game Developers Conference in San Francisco and mingling with possible investors. "There's nothing like being exposed to all the people that are here, all the money, all the opportunities," Tegelaar says. "We didn't realize the benefits were so enormous." |BW|

PHOTOGRAPH BY TIMOTHY ARCHIBALD; CHART BY STANFORD KAY



Man U's Antonio Valencia is on firmer footing than his team's accounts

EDDIE KEOGH/REUTERS/CORBIS

Can Man U Kick Its Debt Habit?

England's top soccer team is winning on the field, but like most other Premier League clubs, it is deep in hock

By Mark Scott
LONDON

Among English soccer teams, Manchester United is in a class by itself. The Red Devils, as fans around the world call them, have been England's top club 16 times since World War II, with 11 English Premier League (EPL) titles in the past 17 years. Man U's financial performance, though, has been less exalted. Thanks to rising interest payments on debts dating from the team's 2005 purchase by U.S. billionaire Malcolm Glazer, Man U's books seem to have more red than its jerseys.

In January the club completed a $747 million bond issue to refinance mounting debt. While Man U's revenue has grown 72% since Glazer took over, to more than $400 million annually, the team also paid $102 million in interest for the fiscal year ended June 30. And Man U would have seen a multimillion-dollar loss if it hadn't managed to sell its best player, Portuguese striker Cristiano Ronaldo, for $120 million. Fans are miffed that the cash has gone to repay loans, not for new players. "A huge amount of money has been taken out of the club with nothing put back in," says Duncan Drasdo, a rabid fan who heads an organization of former shareholders from when the team was publicly traded.

Drasdo wants a change of management—and he might get one. On Mar. 2 a group of financial heavyweights, including longtime Man U supporter (and Goldman Sachs' chief economist) Jim O'Neill, said it was mulling a bid to buy the team from Glazer, whose holdings also include the Tampa Bay Buccaneers. "There's too much leverage going on with Manchester United," O'Neill says. Man U Chief Executive David Gill says any proposal will be rejected.

$4.8 billion

Overall debt for English soccer clubs, 56% of the total for all European teams

Data: UEFA

Man U may be the highest-profile club struggling to balance its books, but it's far from the most troubled. Unlike Man U, many weaker teams have binged on top talent. With no wage caps or other limits on salaries, just nine of the EPL's 20 clubs are profitable, according to the latest data from consultancy Deloitte. All told, English teams have debts of some $4.8 billion, 56% of the total for all European clubs. "Something has gone badly wrong," says Alan Switzer of Deloitte's sports business group.

On Feb. 26, Portsmouth Football Club on England's southern coast filed for bankruptcy after the team couldn't pay $18 million in taxes. Portsmouth shelled out $82 million—three-quarters of its annual revenue—on wages in 2008, the latest figures available. Other clubs, particularly those near the bottom of the rankings, could face a similar fate in the next two years, says sports adviser Pete Hackleton of consultancy RSM Tenon. "Their business models are completely out of whack," he adds.

Liverpool, No. 2 in the EPL last season, also faces mounting debt. U.S. billionaires George Gillett and Tom Hicks, who own big league baseball and hockey teams, borrowed heavily at the height of the credit boom to buy the club for $260 million. Since then, interest payments have increased the debt to $354 million. Liverpool's creditors have demanded $149 million by July. Christian Purslow, the team's managing director, says Liverpool is in talks with potential investors to cover the shortfall.

More money from broadcast rights might give a lift to weaker teams. The league is negotiating TV contracts with overseas networks that could double foreign broadcast revenue. The EPL's global profile, says Bob Mitchell, who negotiates sports deals at law firm Harbottle & Lewis in London, is its strongest asset. "Without worldwide TV rights," he says, "smaller clubs would struggle to make ends meet." |BW|

–With Tariq Panja and Zijing Wu

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Brownnosing for Google Broadband

Cities try almost anything to win the search giant's new Net service, including an "Internet love ballad"

By Olga Kharif

BW 50

Jared Starkey is going all out for Google broadband. The day after Google said it would provide high-speed Internet service to as many as 500,000 people in the U.S., Starkey set up a Facebook page to persuade the company to come to his hometown of Topeka, Kan. Since then, Starkey has passed out bright-orange necklaces made of fiber-optic cable and even organized a rally of 100 Topekans in support of the broadband plan. "I've been talking to absolutely everybody about this," says the 26-year-old owner of a small Web design company.

Cities and towns across the country, hungry for better broadband, are trying to grab Google's attention. The Mountain View (Calif.) company said last month it's planning a new Internet service of 1 gigabit per second, or about 20 times faster than the speediest offering from Verizon Communications. Richard Whitt, Google's Washington telecom and media counsel, says the company may spend "hundreds of millions" on the effort, which will involve stringing fiber-optic lines into homes in a small number of cities. Google is accepting applications on its Web site until Mar. 26.

Google hasn't said whether it will offer the service more broadly in the future or what it will charge, but analysts believe the initiative is more about motivating existing broadband providers than direct financial gain. The average Net connection in the U.S. is 3.9 megabits per second, according to Web services provider Akamai Technologies, well behind the 14.6 and 7.9 averages for South Korea and Japan. If American Net service gets faster, people will likely spend more time watching videos or playing games online, providing Google fresh ways to expand its advertising business. "Google is trying to push the issue, to show what opportunities there are with ultra-fast broadband," says analyst Jason Blackwell of ABI Research.

Municipalities are going well beyond formal applications to be part of the experiment. Greensboro, N.C., is preparing an "Operation Google" gift package for delivery to Google headquarters and has earmarked $50,000 for promoting its broadband effort. The mayor of Topeka renamed the city Google for the month of March. Officials in Duluth, Minn., responded with a video declaring that "in order to prevail in the Google-pandering arms race," every first-born male in the city will change his first name to "Google Fiber." (Yes, it was a joke.)

Many cities, desperate to get the nod from Google, are relying on citizen-led efforts. Activists have set up more than 70 Facebook pages to attract attention to cities like Grand Rapids, Mich.; Columbia, Mo.; and Ventura, Calif. Google may pay heed. "Level of community support is certainly one of the factors we're considering," says a spokesman.

Local companies are getting involved, too, since they hope faster Internet service will help create jobs and business opportunities. A Topeka restaurant called The Break Room handed out 20 coupons for free dinners to people who filled out an online petition in support of Google's broadband service. In Baltimore, small-business owners created a Facebook page called Bmore Fiber! that has attracted 3,850 fans. The activists have also set up a mobile-phone text-messaging campaign that will alert residents to upcoming activities, such as passing out flyers or going door to door to rally resident support. "I've been here for 15 years, and I've never seen this kind of grassroots support come together so quickly," says Andrew Frank, a former Baltimore deputy mayor.

Google won't say what all the criteria are for picking the broadband winners, which has led to some unusual, if impassioned, appeals. On Topeka's Facebook page, locals Kurt Eskilson and Dan Billen posted what they call an "Internet love ballad":

Topeka's a wasteland
for Internet nerds
But could there be
hope? I think that I heard
Google is coming with
speed we deserve. |BW|

–With Brian Womack in San Francisco



ILLUSTRATION BY DAVID RUDES/BW WITH PHOTO BY KSHERITAGE


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By Alan Ohnsman, Jeff Green, and Kae Inoue

Illustration by Brian Stauffer

THE HUMBLING OF TOYOTA

A combination of high-speed global growth and ambitious cost cuts led to the quality lapses that have tarnished the once-mighty brand. How it all went wrong

Toyota Motor has always been fanatical about frugality, and for many years that was good for both the company and its customers. This is a Japanese carmaker that routinely turned down the heat at its employee dormitories during working hours and labeled photocopy machines with the cost per copy to discourage overuse. Its engineers collaborated with suppliers to extract cost-savings without compromising quality. Yet by the middle of the last decade Toyota's virtue had become a vice.

So say current and former auto executives who are trying to grasp how Toyota, with its gold-plated reputation for engineering excellence, slipped up on such a scale, with 8 million cars recalled due to mechanical failures linked by U.S. regulators to 51 deaths. Before company officials knew that runaway acceleration was causing crashes, one of these executives says, a simple manufacturing process would sometimes ignite small fires in a component as a direct result of corner-cutting. It was just one early sign that the focus on cost reduction had gone too far.





Staying competitive no matter what: Okuda, Cho, and Watanabe were responsible for robust cost-cutting and rapid expansion

(TOP, L TO R) HARUYOSHI YAMAGUCHI/BLOOMBERG NEWS; MICHAEL CARONNA/BLOOMBERG NEWS; CHINAFOTOPRESS/SIPA PRESS

Those production mishaps occurred in 2006, a year after company President Katsuaki Watanabe boasted about having squeezed more than $10 billion from global operating costs in the previous six years—this despite an impressive run of profit growth and global market share gains in the middle of the last decade. Then Toyota pushed even harder for more cuts. It asked suppliers to design parts for its Camry midsize sedan that were 10% cheaper and 10% lighter. The company's top U.S. executive, Jim Press, warned his bosses in Japan that vehicle quality was slipping, according to a slide presentation U.S. Senate investigators unearthed in their sudden-acceleration probe. But his warning had no apparent effect.

The redesigned Camry brought out in 2006 had an embarrassing flaw in its headliner, the fabric and composite lining that covers the inside roof of the car. Under pressure to cut costs, the lead Camry supplier, Toyota-affiliated Toyota Boshoku, chose a carbon fiber material that hadn't been approved by Toyota engineers, according to an executive who worked on the redesign. The headliner is made by compressing layers of materials together using a certain amount of heat to mold it. In this case, the carbon fiber required so much heat that the headliner would catch fire.



Ohno's carmaking precepts changed late-20th-century manufacturing

Toyota fixed that problem, but when a North American parts supplier interested in working with the automaker did a teardown of a 2007 Camry, its engineers were surprised by how much the traditional Toyota craftsmanship had been watered down by years of nips and tucks. The padding in the ceiling of the car, though compliant with safety regulations, had been thinned out to save money. A tray for sunglasses used a flimsier type of plastic than previous models. "It was a barebones car at that point," says one executive who declined to be identified for fear of harming business ties with Toyota.

Toyota insists its focus on cost hasn't hurt consumers. "It's not true that by reducing cost you automatically reduce quality," said Jim Wiseman, Toyota's vice-president for North American corporate communications. "Every automaker has to stay competitive relative to price."

True, but probably not with the intensity Toyota brought to cost-cutting and rapid expansion under three successive presidents: Hiroshi Okuda (1995-1999), Fujio Cho (1999-2005), and Watanabe (2005 to 2009). Toyota executives will spend years mopping up after their mess.

At last count, the company faced 109 class actions and 32 individual cases filed in courts in the U.S. and Canada. (In a well-publicized incident on Mar. 8, the owner of a 2008 Prius lost control of his car on a California interstate highway and had to be rescued by police.)

As grave as the current troubles are, they are symptomatic of a larger problem at Toyota: It got carried away chasing high-speed growth, market share, and productivity gains year in and year out. All that slowly dulled the commitment to quality embedded in Toyota's corporate culture.

"The root cause of their problems is that the company was hijacked, some years ago, by anti-[Toyoda] family, financially oriented pirates," Press charged in a recent interview with Bloomberg News. Once the highest-ranking American at the company, with a seat on the board of directors, Press left in 2007 to join Chrysler as vice-chairman and president, but departed from there after last year's bankruptcy. The financial pirates, he said, "didn't have the character necessary to maintain a customer-first focus."

The embodiment of character at Toyota, as any new engineering hire there learns, is a man named Taiichi Ohno, the innovator widely credited as the genius behind the Toy-



off-road stuff. It also botched some key product launches. It introduced the T100 truck in the U.S. with an underpowered engine, and a 1995 redesign of the Corolla for the Japanese market fell flat.

Okuda and his team started turning things around on the product front while embarking on one of the most aggressive overseas expansions in automotive history. Between 1995 and the end of 2009, Toyota roughly doubled, to 50, the number of overseas plants and manufacturing facilities in North America, Asia, and Europe in a bid to improve its market responsiveness and sidestep potential trade disputes about car exports from Japan. This coincided with a massive product rollout that penetrated new categories ranging from the boxy Scion xB to the one-ton Tundra pickup to the hybrid Prius compact. In the U.S., Toyota gained market share at "a kind of speed no other carmaker has ever experienced in the past," said Koji Endo, an analyst with Advanced Research Japan in Tokyo.

By the late 1990s the Corolla sedan and the 4Runner and RAV4 sport-utility offerings were all selling well, and plans were under way to invade Detroit's cash-cow minivan and large pickup truck categories. In the all-important North American market, Okuda spent big to double total vehicle capacity, to 1.2 million units, by 1998. To launch the Sienna minivan, he expanded capacity at Toyota's Georgetown (Ky.) plant, already the production base for its Camry and Avalon sedans.

Early in Okuda's tenure as president there was a lot of talk about grabbing a 10% share of the global auto market. By the time he moved up to the chairman's job in 1999 to make way for Cho, the goal was 15%. Cho was less flamboyant than Okuda and studied law at the prestigious University of Tokyo. Yet early in his career Cho became fascinated with the Toyota Production System and mastered its best practices. (He put that knowledge to use in 1988, supervising the launch of the Georgetown plant.) Cho often talked about the "criticality of speed" in product development cycles and the importance of responding to changes in the marketplace. Ohno's precepts were beginning to morph into something he might not have recognized.

By 2003 a lot of things were going right at Toyota. Profits were booming, and in November of that year it enjoyed a market capitalization of $110 billion—more than that of GM, Ford, and DaimlerChrysler combined. (Today, despite its troubles, Toyota is valued at $132 billion.) In the U.S. it had finally pieced together a strong lineup of high-margin SUVs, once the profit sanc-

PUTTING THE PEDAL TO THE METAL

Major cost-cutting and expansion programs that strained the automaker

LOCALIZED MANUFACTURING

Starting in the late 1990s, Toyota set up manufacturing hubs in Asia, North America, and Europe that relied more on locally based suppliers and design teams to tailor vehicles to local tastes.

CCC21

That's short for Construction of Cost Competitiveness for the 21st Century. Started in 1998, the initiative wrung out more than $10 billion of savings over six years by redesigning parts and working with suppliers to cut costs.

VALUE INNOVATION

This program, a more ambitious version of CCC21, started in 2005. It promised more savings by making the entire development process cheaper and by further trimming parts and production costs.

GLOBAL 15

In 2006 a leaked copy of a Toyota "global master plan" called for reaching a 15% share of the world car market by 2010. Toyota overtook GM as the world's biggest carmaker in 2008 and today has a 11.7% share of the worldwide auto market.

ota Production System. With a handful of other executives during the 1950s, Ohno developed a set of in-house precepts on carmaking efficiency that later evolved into such concepts as lean manufacturing and just-in-time inventory management. Ohno's ideas not only changed the auto industry, they changed late-20th-century manufacturing. At their core was an attention to detail and a noble frugality that shunned waste of every kind. As Ohno's concepts were handed down to successive generations of Toyota executives, however, the purity of the message appears to have been slowly lost.

The traditions of the company began to change in 1995 when family elders, led by then-Chairman Shoichiro Toyoda, tapped Okuda to take over the company from 68-year-old Tatsuro Toyoda, who had been waylaid by a stroke. The company was widely thought to have lost its edge, and Okuda (a black belt in judo) was just the sort of hard-charger to help get it back.

In jobs ranging from accounting and purchasing to international and domestic sales, he was a nonstop manager who liked to test-drive every Toyota under development. He also could be impolitic. In 1995, Okuda called his Detroit rivals "stupid" for trying to import bulky cars ill suited to Japan's narrow side streets.

Toyota needed Okuda's in-your-face approach. Glacial decision-making and poor execution were resulting in major mistakes. Toyota stuck with conservatively styled sedans when everybody in the U.S. and Japan wanted the more daring,



Press warned his bosses in Japan that vehicle quality was slipping, to no apparent effect

ROY RITCHIE/WONDERFUL MACHINE

tuary of U.S. automakers, ranging from the $19,000 RAV4 to the $65,000 Lexus LX470. Meanwhile, the Prius was starting to take off, creating mass market interest in eco-friendly cars.

At the same time, Cho, Okuda, and other top executives were pushing ahead with a program dubbed CCC21 ("Construction of Cost Competitiveness for the 21st Century") that had been started in 1998. In implementing CCC21, no detail was too small. For instance, Toyota designers took a close look at the grip handles mounted above the door inside most cars. By working with suppliers they managed to cut the number of parts to five from 34, which helped cut procurement costs by 40%. The change slashed the time needed for installation by 75%—to three seconds. "The pressure is on to cut costs at every stage," Takashi Araki, a project manager at parts maker and Toyota affiliate Aisin Seiki, told *BusinessWeek* at the time.

By mid-decade, when Watanabe, a trained economist, became president, Toyota had incredible numbers to share with Wall Street analysts. On the job as Toyota's chief executive for less than three months, Watanabe told New York's financial community at a Sept. 12, 2005, meeting in Manhattan that CCC21 had wrung out more than $10 billion in savings over six years. "Under CCC21 activities, which I led, Toyota realized cost reductions of more than 200 billion yen ($2.2 billion) a year on a consolidated basis," he said.

It wasn't enough. Next up was what he called an "aggressive version of CCC21," dubbed Value Innovation, which promised more savings by making the entire development process cheaper and faster, further trimming parts, production costs, and time to market. Toyota had managed to slash the time it took to bring models into production once a design was final to about 12 months, compared with an industry average of between 24 and 36 months.

A credit bubble and soaring home prices in the U.S. had Americans buying Camrys and Lexus SUVs in droves. Toyota raked in $55 billion in operating income during its fiscal years running from 2006 to 2008. Shares traded in Tokyo (Toyota also has stock listed in New York and London) shot up 112% from mid-2005 to February of 2007.

Yet during these hyperspeed growth years there were signs of trouble. That's when Press, Toyota Motor's top U.S. executive, warned his bosses that quality was slipping and that regulators were stepping up scrutiny.

Reports of more serious problems started to get the attention of U.S. regulators far earlier in the decade. The National Highway Traffic Safety Administration opened eight investigations of unintended acceleration of Toyota vehicles from 2003 to 2010, according to Safety Research & Strategies, a Rehoboth (Mass.) group that gathers data from NHTSA and other sources for plaintiff's attorneys and consumers, though the carmaker's problems only became widely known to the public this year.

"THE COMPANY WAS HIJACKED ... BY FINANCIALLY ORIENTED PIRATES," SAYS FORMER U.S. CHIEF JIM PRESS

Toyota's fortunes, and that of the entire industry, took a nasty turn starting in late 2007 as the financial crisis hit and oil prices spiked to $145 per barrel in July of 2008—a combination that brought on the global recession that later pushed GM and Chrysler into bankruptcy. Last September, at a meeting with Toyota investors in Tokyo, Akio Toyoda, who succeeded Watanabe in June 2009, said an annual goal had been to boost global sales by as many as 700,000 vehicles a year, more than three times the previous increase, according to a former executive who attended the gathering. The accelerated production had outstripped the abilities of company engineers and led Toyota to outsource more development work to suppliers.

On Feb. 24 of this year, the grandson of company founder Kiichiro Toyoda said during testimony before a congressional committee: "I fear the pace at which we have grown may have been too quick. ... Priorities became confused, and we were not able to stop, think, and make improvements as much as we were able to before."

Toyoda and other top executives have vowed to fix the sudden-acceleration problems and other quality lapses that have surfaced in so many of its models. In a bid to win back customers, Toyota is offering incentives such as no-interest loans and discounted leases, which may reignite sales. Still, Toyoda and his team will be spending many months trying to absorb a painful lesson about what happens to a great company when ambition gets too far ahead of tradition. |BW|

–With David Welch, Margaret Cronin Fisk, and Doron Levin in Southfield, and Ian Rowley, Makiko Kitamura, and Yuki Hagiwara in Tokyo


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REVENGE OF THE CABLE GUYS

If you think online TV will be free forever, think again. The cable companies have a plan to keep control—and stick you with the bill

By Ronald Grover, Tom Lowry, and Cliff Edwards
Illustrations by Matt Mahurin

Once upon a time, not so long ago, a bunch of small companies in Silicon Valley thought the future of television was theirs. Soon, the thinking went, TV would be everywhere. Frequent fliers would tune in on laptops and vacationers on tablets from the beach. If so inclined, you'd be able to watch *Glee* on a cell phone in a tree house. The network suits and the cable guys just didn't have the digital chops to make it happen. Fueled with venture money, tech companies with names like Boxee, Roku, and Sezmi pursued their dream of untethering viewers from their TV sets—and owning a piece of the advertising revenue. ¶ As the big picture comes into focus though, it looks like the cable guys are





playing the lead roles, using the $32 billion they pay content providers each year as leverage. The alphabet soup of newbies is still waiting in the wings for a moment that might never come.

What happened? Part of the answer is TV Everywhere, a service in its infancy, conjured up in quiet strategy sessions by Jeff Bewkes and Brian Roberts, the CEOs of Time Warner and Comcast. They took a lesson from the music labels, which looked up one day to find that Steve Jobs and Apple had taken control of their inventory. The cable guys came up with a quick fix, one so technologically simple that you don't have to be a geek to get it: Viewers can watch shows for free, but only if they're cable subscribers first. In other words, as long as you tap a subscription code into your device—any device—you can watch anything you want, whenever you want.



It's worth hitting pause here for a moment. Right now, Time Warner is offering the service in only a few markets. Comcast has rolled out a trial, or beta, version to about 80% of its subscribers. There are plenty of kinks to be sorted out. And as usual when it comes to show business, nothing is quite as simple as it appears. For TV Everywhere to work, the behemoths of the business must stand together and stamp out the rampaging weed called free. After all, if you can get programing for free—real free—why would you ever pay a cable bill?

SELF-PRESERVATION

That's what was worrying Time Warner's Bewkes in the fall of 2008. Back then, Time Warner ran the country's second-largest cable operator (spun off in March 2009) and was also a content provider. Bewkes had previously been in charge of the company's HBO unit, turning the premium cable channel into a profit machine with 30 million subscribers.

Bewkes watched with growing alarm as Hollywood stampeded online to offer TV shows and movies for free, say two Time Warner executives. At the time, Hulu, a video site operated by Fox, NBC Universal, and Disney, was about a year old. For TV addicts, Hulu was a near miracle. Miss the latest episode of *Damages* on the FX channel? If so, you could watch Glenn Close play a conniving lawyer on Hulu 24 hours later for free. Hulu's owners shared the advertising revenue from the site, but everyone knew it wasn't making money and there was no clear path to profitability. As he watched one entertainment company after another put their TV shows and movies online for free, say the executives, Bewkes began to fear that the pay TV industry would eventually find itself in the same untenable position as newspapers.

That's when the scene shifts to Wisconsin, where HBO was running an experiment in Milwaukee and Green Bay. HBO was letting people watch its programing online as long as they could prove they were HBO subscribers. The results of the test were unexpected: Viewers who tuned into *Big Love* on their laptops didn't spend any less time watching HBO on their TV sets. Bewkes was buoyed by the possibility that the same model might work more widely and that his cable properties might be able to keep subscribers from gravitating elsewhere, says a Time Warner executive involved in the discussions. Bewkes told his team: "We can't just talk about it, or play the victim. We need to build a model," the executive recalls. The Time Warner CEO was unavailable for comment.

It wasn't the first time the cable industry had found itself in danger of being outflanked by tech-savvy rivals. In 1999, TiVo began selling a handy little box that allowed people to record dozens of hours of TV shows on a hard drive. After a certain amount of handwringing, the cable guys struck back with overwhelming force. They figured out the technology



and marketed their own digital video recorders, for which they charged subscribers an extra $10 or so a month. Next came Apple. Along with Amazon.com and others, Steve Jobs began renting TV shows online. The cable companies beat back that onslaught by beefing up their video-on-demand offerings and giving subscribers a bunch of free shows with a few clicks of the remote. "The cable industry has been very good at not jumping too early on a technology, and watching it play out first," says Colin Gounden of Grail Research, which advises companies on new products. "They have a knack for getting the timing right."

The new attack from Silicon Valley was the most serious yet, because it threatened to permanently cut the coaxial connecting the cable companies and their subscribers. "We wake up every day and there is some new competitor out there—a Roku or a Boxee," says Melinda Witmer, Time Warner Cable's programming chief. "People like to think of cable operators as monopolists, but we face a lot of competition just to keep the business we have." Technically there was nothing too complicated about Bewkes' plan to expand the Milwaukee experiment. The new service would need a way to automatically confirm that people were paid-up subscribers. Other than that, TV Everywhere, as Bewkes called it, would mostly use existing online infrastructure and established user interfaces.

"FRIEND, NOT A FOE"

Far more daunting was the prospect of persuading the rest of the industry to join up. Unless most of the pay TV and content players banded together, TV Everywhere wouldn't work; viewers could simply flock to sites that didn't require a cable subscription. Bewkes, say two Time Warner executives, decided to float his proposal with Roberts, the chief of Comcast, the largest cable system in the U.S., with 24 million subscribers. In early 2009, Bewkes began wooing Roberts, traveling from his New York City office on Columbus Circle to Comcast's imposing 57-story headquarters in Philadelphia.

Roberts long ago realized that online video was important to the future of his company. In 2006, Comcast had created an interactive media unit that poached heavily from Silicon Valley. The company's first major development project was Fancast, a video site like Hulu that offered hundreds of shows free to all comers. Roberts, who declined to be interviewed for this story, had unveiled Fancast at the Consumer Electronics Show in Las Vegas in early 2008. Before long, says one Comcast executive, he began thinking about a service that would offer much more content—but only to Comcast subscribers.

PHOTOGRAPHS BY (FOOTBALL) ROB TRINGALI/SPORTSCHROME/GETTY IMAGES; (COMPUTER) RYAN MCVAY/GETTY IMAGES; (THE WIRE) HBO/COURTESY EVERETT COLLECTION

TV EVERYWHERE

Comcast is testing a beta version of its service, called Fancast XFinity. Here's how it works:

FANCAST xfinity tv

WHO CAN LOG ON

Subscribers to Comcast's digital cable and broadband.

WHAT YOU GET

Nearly 20,000 TV shows and movies from two dozen channels, including HBO, Discovery, AMC, FX, and NBC. With clips and trailers, the catalog amounts to 80,000 videos. As Comcast cuts deals with other programmers, more content will become available.

WHERE YOU SEE IT

Subscribers can use the service on three PCs and open secondary accounts for their kids; eventually XFinity will be available on smartphones and tablet PCs.



When Bewkes came calling he didn't have to convince Roberts of the importance of preserving the subscription model online. And like most everybody in the cable industry, Roberts was aware of HBO's online experiment in Wisconsin.

Roberts and Bewkes initially disagreed on one big point, say two Time Warner executives who say they can't speak on the record because the discussions were sensitive. Roberts believed subscribers should be required to go to a central site operated by their pay TV provider in order to view cable shows. Bewkes, true to his divided soul as a content creator and distributor, felt users should be allowed to tap into any cable channel's Web site as long as it was part of the TV Everywhere ecosystem. Bewkes, say the executives, reasoned that letting individual channels keep their own sites would allow them to maintain their brands. Eventually, Roberts agreed.

WINING AND DINING

The Time Warner executives say Roberts and Bewkes saw the cable industry's annual convention, held last April in Washington, D.C., as an opportunity to proselytize about TV Everywhere to the rest of the industry. During one panel discussion, Roberts told his audience that online video was "a friend, not a foe" and that for Hollywood it represented a new way to make money "in this horrific advertising environment."

In Hollywood, studios and cable channels were hearing a very different message from the Silicon Valley upstarts who wanted to cut deals for their programing. Netflix's Ted Sarandos pushed studio executives to give his company the latest movies for its online video service. Steve Jobs proposed launching a stripped-down cable service that would cost consumers $30 a month. Boxee founder Avner Ronen says he traveled to Los Angeles from his base in New York so many times that his "plane knew the way."

Phil Wiser, founder of Sezmi, an online TV subscription service, says his goal was simple: to "replace cable and satellite." He flew executives from NBC Universal, Sony, the Discovery Channel, and others to Sezmi's offices in a converted horse barn in Northern California, where he wined, dined, and pitched them. Sezmi wanted the content creators to allow him to use their movies and TV shows for an à la carte service that would give customers the freedom to pay for only what they wanted to watch. The studios declined, so he decided to borrow the industry's subscription model. Owners of Sezmi's $299 set-top box would receive network and cable shows for $19.99 a month, about a third the cost of a typical cable subscription.

Wiser told the studios that he would match what cable was paying for episodes of such shows such as *The Real World*, *Top Chef*, and *Damages*. It was an unprecedented offer for a

(PLAYSTATION) COURTESY SCEA

THE CORD CUTTERS Ten rivals to cable—some promising, none perfect

Apple TV

A set-top box that brings Web video to TV

PRICE: $229

PRO
Handles a swath of content, including movies from Apple's iTunes store, YouTube videos, and Flickr photos

CON
Too expensive for heavy users; big up-front cost



BOXEE

Downloadable software that allows people to watch TV shows online

PRICE: It's currently free, but Boxee will soon offer a set-top box that is expected to cost less than $200

PRO
The software is easy to navigate and allows people to see what their friends are watching

CON
Needs a cable to connect to the TV; installation can require multiple steps

hulu

Owned by NBC Universal, Disney, and Fox, the elegant site boasts a large catalog of TV shows and movies

PRICE: Free, advertiser-supported

PRO
Shows are available after the first airing on TV; commercial interruptions are minimal

CON
Most recent TV shows are available only for limited time; some network shows are unavailable

NETFLIX

Besides its famous DVD-by-mail service, Netflix also streams movies and TV shows to a PC

PRICE: $8.99 per month, with more expensive plans available

PRO
Large selection of movies, no added cost for online streaming

CON
Newest movies are not always available to be streamed



PS3 PlayStation 3

Users can download and stream TV shows and newly released movies

PRICE: $300 for the base model

PRO
No subscription required, works on the PlayStation Portable handheld; includes Netflix streaming service

CON
Not yet available on other mobile devices



startup, but only one company initially agreed to make its content available: NBC Universal, which is already available on Hulu. Wiser says it took another 18 months to lure more content providers, including Turner Broadcasting (owned by Time Warner) and Discovery Networks. What's more, Wiser acknowledges he had to pay the content guys more than they get from the big cable companies. When Sezmi boxes went on sale in Los Angeles in February, the service was missing ESPN, The History Channel, The Food Network, HBO, and other popular channels. "Trying to do this is not for the faint of heart," says Wiser, a former Sony executive. "These firms see dozens of new pitches every week, so they're skeptical."

Skeptical—and satisfied. The makers of movies and TV shows are attached to the billions they receive from cable companies and are understandably reluctant to engage in grand experiments with upstarts touting unproven business models. Joshua Sapan runs Rainbow Media Holdings, which controls AMC, IFC, the Sundance channel, and others. He says tech companies have approached him about licensing AMC shows, but, he asks: "Why would I license my channel to someone and give them *Mad Men* the day after it shows up on AMC?"

MAKERS OF MOVIES AND TV SHOWS ARE ATTACHED TO THE BILLIONS THEY RECEIVE FROM CABLE COMPANIES AND RELUCTANT TO ENGAGE IN GRAND EXPERIMENTS WITH UPSTARTS

Back at Time Warner Center in New York and One Comcast Center in Philadelphia, the cable operators began to realize they had the studios locked down. As Frank Biondi, former president of the media giant Viacom, puts it: "Why would [the studios] make a deal with a competitor to their largest customer and risk angering them?"

In summer 2009, Bewkes and Roberts joined forces to take the TV Everywhere model out for a spin with 5,000 Comcast subscribers across the country. Those viewers were able to tap into programing provided by cable channels TNT and TBS, both owned by Time Warner. The speed with which the industry moved on from that trial balloon is a measure of just how important locking in subscriber revenue is to cable's future. In December, Comcast rolled out a beta version of the

Roku

Streams movies, TV shows, other content from set-top box to the TV

PRICE: $79.95 for base model, up to $129.99 for high-def version

PRO
Easy to install, wireless access eliminates need for added cable; no annual fees

CON
Subscription fee required for premium content, including Netflix movies and Major League Baseball



sezmi

Digital video recorder that offers local broadcast channels, on-demand content, and some cable channels

PRICE: $299 for the box/$19.95 for a monthly subscription

PRO
Cheaper than traditional cable and satellite offerings; one box combines Internet content with cable and DVR

CON
The box is pricey and not yet widely available

slingbox

Streams live or recorded content from a TV to PCs and leading smartphones

PRICE: $299 and free with the Dish Network DVR service

PRO
Works almost anywhere in the world with no monthly fees

CON
Works best with cable or satellite service



TiVo

Digital video recorder that also streams movies or TV shows from set-top box to TV

PRICE: $149 for the cheapest of three models, plus monthly or lifetime service fee

PRO
Can be configured to use instead of cable box; highly navigable menus

CON
Up-front equipment cost in addition to fees for some content such as Netflix



XBOX 360

Streams high-def movies and TV shows from Netflix, other content providers

PRICE: $299 for the base model, plus monthly or lifetime service fee

PRO
Intuitive software makes it easy to download premium content

CON
Non-Netflix content is limited and must be downloaded to hard drive, not streamed



(XBOX) MICROSOFT CORP. VIA BLOOMBERG NEWS

new service, now christened Fancast XFinity TV. Time Warner Cable has a trial going with nearly 10,000 customers in Syracuse, N.Y., New York City, and Columbus, Ohio. Verizon Communications is testing a service nationally, and DirecTV, the satellite operator, plans to as well.

Comcast's service is the furthest along and provides a window on where TV Everywhere is headed. Only subscribers who pay for digital cable—and take Comcast's broadband service—are eligible. (The company is still working out how to bring XFinity TV to the third of its subscribers who get broadband from other companies.) Subscribers can tune into two dozen channels, from CBS to Animal Planet, and view 19,000 full-length TV shows and movies. They can use it on as many as three PCs and get most episodes 24 hours after they first air on TV. Much of that was available on Comcast's free site, but now shows on HBO and the Discovery channel have been added to the lineup. Eventually, Comcast aims to let subscribers access XFinity on their smartphones and tablets.

TV Everywhere has a ways to go before the cable guys can declare victory. There's a ton of stuff to figure out—how the ad model will work, devising a new ratings system with Nielsen. And then there's the question of profits. The cable guys like them, and they're not real comfortable with free. So chances are, down the line, the costs of the new free will probably sneak onto subscribers cable bills. And you know what? We'll all keep paying. |BW|

BREAKING UP IS HARD TO DO

An Oregon couple quit cable but missed their favorite shows

By Ronald Grover

As the recession deepened two years ago, Taraneh Foster and Joe Fultz decided to do without cable. Like many Americans, the Portland (Ore.) couple had signed up for a "triple-play" deal, where for about $100 a month you get basic cable TV, broadband, and phone service. "It was crazy," Foster says, "but cheaper than buying TV and Internet separately." Foster, 28, and Fultz, 30, both had cell service and hadn't even bothered to buy a home phone. Plus, they were already watching many of their favorite TV shows online. So they canceled the TV and phone service and began paying their cable company, Comcast, about $40 a month for Web access only.

At first, the new arrangement seemed to work out fine. The couple began surfing the Internet for their TV shows. Fultz was a big fan of *It's Always Sunny in Philadelphia*, the quirky FX comedy starring Danny De Vito. He began watching it on Hulu for free 24 hours after it appeared on TV, with only minimal commercial interruptions.



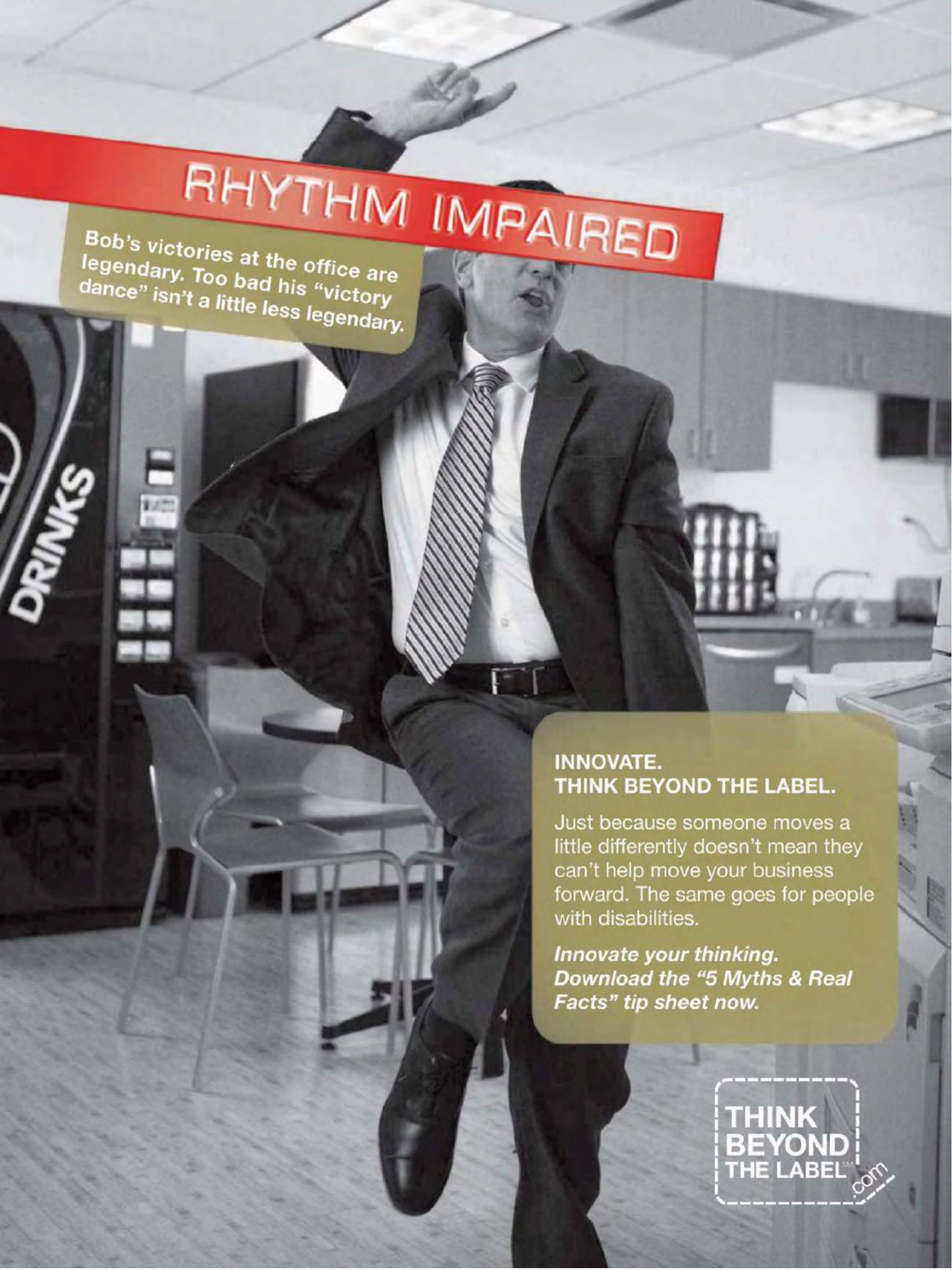
After cutting the cord, Foster decided "to be friends again with Comcast"

Foster was hooked on *America's Next Top Model*. They didn't have a way of connecting their computer to their big-screen television, so they turned Fultz's 24-inch Macintosh screen toward their couch and watched that way. "We could get a lot of what we wanted," says Foster. "Better yet, it was free."

Before long, however, the couple began to realize that "a lot of what they wanted" wasn't enough to satisfy their television cravings. Foster couldn't find enough recent episodes of the Lifetime show *Project Runway*. Fultz missed the left-leaning political talk show *Countdown with Keith Olbermann* that airs five nights a week on MSNBC. It began to dawn on Foster and Fultz that they couldn't live without cable after all. "We decided to be friends again with Comcast," says Foster.

Last fall the couple moved to a larger apartment and called the cable company. The good news was that their building had a deal with Comcast that allowed residents to take cable and Web service for only about $20 more than the Internet alone. The couple declined to pay extra for premium channels like HBO. Instead, they pay $9 a month to Netflix and stream online movies to the television through Foster's Xbox game console. "We liked it better when it was free," says Foster. "But we've gotten too used to the convenience." Families all over America are making the same kind of calculation. Breaking up with the cable guy is hard to do. |BW|

JOHN KEATLEY/REDUX


RHYTHM IMPAIRED
Bob's victories at the office are legendary. Too bad his "victory dance" isn't a little less legendary.
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Support for Chávez depends on subsidized staples for the poor, but state meddling in the food supply means shortages and seizures of private supermarkets

By Geri Smith
CARACAS

It's 10 a.m., and tempers are already flaring at the Cada supermarket in Caracas' San Bernardino neighborhood. The store has just taken delivery of two pallets of 4- and 11-pound sacks of sugar. With dozens of shoppers swarming around him, Rigoberto Fernández tries to pass out the bags one by one. The clerk hands a smaller one to a gray-haired woman, but she flings it back. "How dare you tell me I can't have one of the larger bags?" she screams. The sack splits open, spilling sugar everywhere. ¶ Within 10 minutes, the shipment has vanished. "I am so fed up with these food shortages," Fernández mutters as he sweeps up the mess. "People get desperate and start behaving like animals."



ISAAC URRUTIA/REUTERS

CEREAL SOCIALISM IN VENEZUELA



An Exito supermarket: Sales are off since the government takeover in January

Venezuelan President Hugo Chávez's response to the food shortages: find a scapegoat, in this case supermarket owners. On Jan. 17, the mercurial leader expropriated six Exito stores, controlled by France's Groupe Casino. A month later he seized Cada, another Casino chain, with 35 supermarkets and eight distribution centers.

El Presidente's efforts to transform his country into a Cuban-style socialist state are sputtering. With its vast oil wealth, Venezuela shouldn't suffer from shortages, yet inefficient farms, government takeovers of supermarkets, and a 50% currency devaluation in January have thrown the food supply into disarray. That's bad news for Chávez, whose anti-capitalist message and ceaseless drive to undermine U.S. influence in Latin America have made him Washington's biggest headache in the region. Chávez's approval rating among Venezuelans has dropped to about 45% from 70% three years ago.

Supplying low-cost food to the poor has been a centerpiece of Chávez's presidency. He has expropriated food processors, stores, and more than 6 million acres of farms and ranches, convinced that the government can feed Venezuela better than the private sector does. Under state ownership, though, production has suffered. From 1999 to 2008, per capita, sugar cane was off by 8%, fruit declined by 25%, and beef production dropped by 38%, according to Carlos Machado, an expert in agriculture at the Institute of Higher Administrative Studies, a business school in Caracas. "The cooperatives have failed and our cattle ranching has been decimated," Machado says.



Muñoz: "My family hardly ever goes to regular supermarkets anymore"

RICARZ/PHOTOS

While Chávez was flush with oil profits, it was easy to take up the slack with purchases of chicken from Brazil, beef from Argentina, and powdered milk from New Zealand. Food imports jumped from $1.3 billion in 1999, when Chávez took office, to $7.5 billion in 2008—about 70% of what Venezuelans eat. But falling crude oil prices and last year's 3.3% contraction of the economy left Chávez with less money to buy food abroad, or to prop up poorly run state farms and food processors. Government officials "think they know how to run businesses, but they just run them into the ground, just like they're running the country into the ground," says 47-year-old homemaker Antonia Rangel, one of the shoppers who managed to get a bag of sugar at the Cada store.

"SOCIALIST MEGASTORES"

A new consumer protection law, which went into effect on Feb. 1, allows Chávez to expropriate virtually any company if he deems it to be in the national interest. Exito's alleged misdeed: raising food prices following the January devaluation (though two months later, on Mar. 9, the government authorized stores to boost prices on some basic goods by as much as 35%). Chávez wants to transform the chain's outlets into what he calls "socialist megastores" that sell food, appliances, and clothing with virtually no markup. "The measure is one further step in the Venezuelan state's policy of transforming capitalism into socialism," Chávez declared on his weekly *Hello President* TV show. Exito's parent and the government haven't disclosed any details on compensation.

The supermarket seizures have alarmed grocers, but few are willing to speak publicly for fear of more harassment. "This is one of the worst times we've ever lived through," says the CEO of a major supermarket chain. "We live in constant fear that we could be shut down or taken over by the government."

Chávez has been skirmishing with supermarkets for years. In 2002, big food producers and distributors participated in a two-month nationwide work stoppage that nearly brought the economy to its knees. In response, Chávez opened a rival network of government-run grocery stores, where more than a quarter of Venezuelans now shop.

The biggest state-owned chain, Mercal, has 16,600 outlets, ranging from street-corner shops to huge warehouse stores. They employ 85,000 workers selling basic products such as rice, sugar, and beans at prices as much as 40% be-



low those the government sets for private stores. Mercal also has a fleet of trucks that serve street markets, and it offers free lunches and afternoon snacks at 6,000 soup kitchens. "Mercal is a very noble mission that contributes to a higher quality of life for Venezuelan families," says Carlos Alonzo Sánchez, manager of a busy Mercal store near El Junquito, a vast hillside shantytown on the outskirts of Caracas.

Joelis Muñoz recently carted 9 pounds of sugar, 7 pounds of rice, and 4½ pounds of corn flour home from Sánchez's Mercal outlet. Her bill was $4.88, half what it would have been at a private supermarket. "Since the government opened these stores, my family hardly ever goes to regular supermarkets anymore," says the 21-year-old single mother.

CHEAP CHICKEN

The state-run stores serve as a platform for Chávez's revolutionary message. In the middle-class California Norte neighborhood of Caracas, an outlet of a second government-controlled chain called PDVAL (owned by state oil company Petróleos de Venezuela, or PDVSA) offers frequent reminders about the source of the bounty. At the entrance, a banner proclaims: "Food Sovereignty! All power to the people!" A few feet down the first aisle, a placard reminds shoppers that the "government is fighting for your food security." Says Luis Pedro España, a sociologist at Andrés Bello Catholic University in Caracas: "It's quite clear to anyone who shops at state-run stores that they owe it all to the President, who brought cheap chicken to the people."

Sometimes, however, there aren't any cheap chickens to sell. The PDVAL store offers tomato sauce from Spain, nutritional drink mixes, and cans of tuna at regulated—but not subsidized—prices. On a recent Friday, though, there's no chicken, beef, or sugar. To fill empty shelves, the store has stocked an entire aisle with nearly 1,000 bottles of cooking oil made by a company the government took over two years ago. Another aisle is filled with hundreds of bags of corn flour. A third is jammed with industrial quantities of dried oregano and curry powder.

When scarce products do arrive, word spreads fast and long lines form. "I can only let one or two people in at a time so things don't get out of control," says Omar Gálvez, manager of a small Mercal outlet in Petare, a rough Caracas slum.

Supplying Venezuelans with cheap chicken isn't cheap. Félix Osorio, Chávez's Food Minister, oversees Mercal from a spacious office filled with paintings, handicrafts, and other gifts from constituents. Osorio, a 40-year-old Army lieutenant colonel, says the government will spend $605 million this year on food subsidies, plus $1.8 billion to run the Mercal system. "Food is a basic necessity, and not mere merchandise," Osorio says, munching on a midnight snack of white cheese

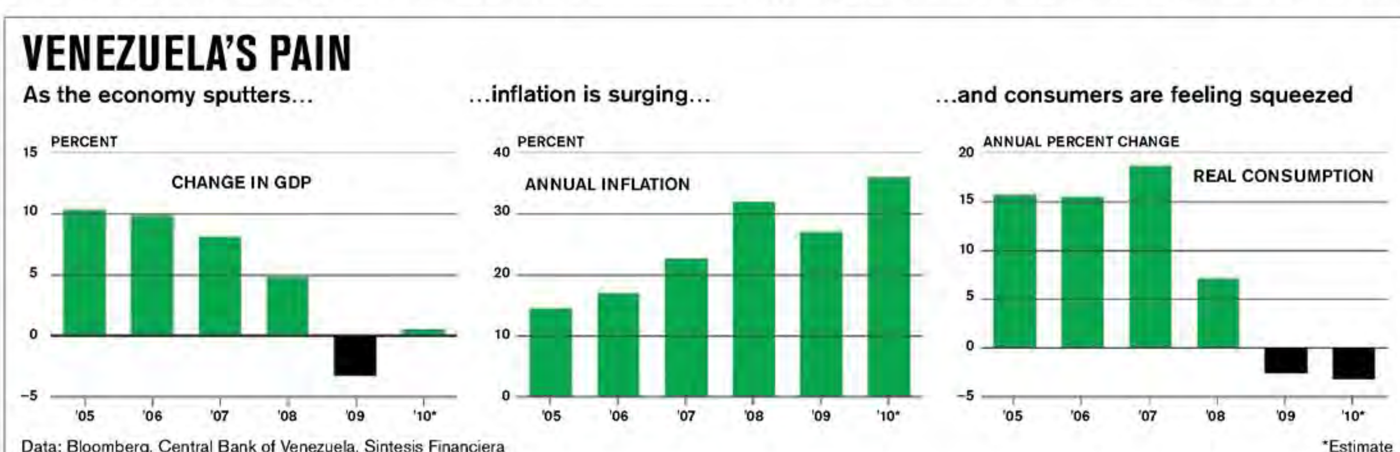


CHART BY STANFORD KAY



PDVAL offers a platform for Chávez's revolutionary message

RICAR2/PHOTOS

and fried beef empanadas after a long day in the field. "The capitalists," he says, "don't see it that way."

Even so, the government knows it can learn something from the people it frequently calls "squalid capitalists." Taking control of the Exito and Cada supermarkets makes sense, Osorio says, because the government needs more expertise in large-scale retailing. The authorities are negotiating with Groupe Casino and may allow the French company to stay on as a minority partner to help keep the chain running smoothly. Casino declined to comment.

SUDDEN SHUTDOWNS

The capitalists, though, face constant oversight. Members of Cuba-inspired "community councils," or neighborhood watch groups, can make unannounced inspections to look for signs of hoarding. One executive from a nationwide chain grouses about constant visits from tax authorities, the consumer protection agency (to check prices), workplace safety inspectors, and even the National Guard, which monitors store hours to make sure they don't stay open too long and use too much electricity at a time of widespread blackouts. Even when no infractions are found, the executive sighs, "The inspector can say, 'It doesn't matter, I have orders to shut you down for 24 hours,' and he does it—just like that."

Supermarket managers estimate that the government regulates prices on about 20% of the items they sell, but these products account for up to 40% of volume. "We make zero profit on most of the regulated foods, so we have to make up for it by charging more for other goods," says Carlos Hernández, manager of Los Campitos, a small grocery in Caracas' upscale El Rosal neighborhood. And at Exito and Coda stores, says one executive, the government seems intent on eliminating any possibility of turning a profit. "How are they going to replace freezers and forklifts as they wear out?" he asks.

Supermarket owners are watching how the government manages Exito, renamed Bicentenario in honor of this year's 200th anniversary of Venezuela's independence from Spain. Since the takeover, sales have sagged, according to Sintesis Financiera, an economics consultancy. Now suppliers concerned over delays in payment appear to be slowing deliveries, prompting Chávez to warn 60 companies that they may be expropriated if they fail to double deliveries to the chain.

With legislative elections scheduled for September, the fiery President is likely to continue cracking down on food retailers. Although he doesn't face another presidential vote until 2012, he's determined to hold onto his party's majority in the National Assembly. Chávez has won the loyalty of poor Venezuelans with his food subsidies, but as inflation erodes spending power, that support is flagging. After climbing by more than 15% annually from 2004 to 2009, consumption has started to fall, Central Bank data show.

As supermarket owners fret about further expropriations, Venezuelans increasingly say socialism isn't the right path. In a poll by researcher DATOS taken two weeks after the Exito seizure, 58% of respondents said they disapprove of Chávez's takeover of stores. Another DATOS survey found that 86% don't think Cuba is an appropriate model for Venezuela. Chávez "is moving in the opposite direction from what people say they want for their country," says DATOS director Joseph Saade. "People look at everything the government has taken over and they're seeing that the companies have become dysfunctional." |BW|

HOW TO PLAY IT 084

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Doha's skyline, funded by energy, is working through a real estate downturn

QATAR ON THE CUSP

By bringing its vast gas reserves to the world, the tiny emirate is making some investors forget all about Dubai. Its most ambitious play: turning gas into liquid oil

By Stanley Reed and Robert Tuttle

THOMAS HALEY/SIPA PRESS

A lesser Dubai: That's the first impression a visitor gets touring downtown Doha, the capital of the Gulf emirate of Qatar. Dubai (population 1.4 million) has its famous ultramodern skyline and man-made islands, its wild young rich kids, and—since the real estate boom went bust—plenty of empty office space. Qatar (population 1.5 million) has semi-vacant glass towers and its own artificial island, a handsome Islamic museum designed by I.M. Pei, and young men racing through the streets in Ferraris and Porsches.

But the differences between the two are vast. Dubai became an entrepreneurial hot spot and global real estate play precisely because it lacked the natural resources that are now making Qatar one of the region's most important places. After more than a decade of careful, costly develop-

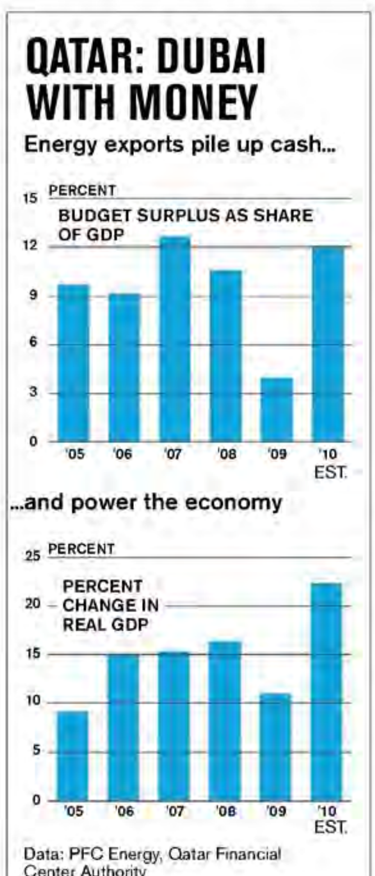


ment, the Qataris are starting to reap the benefit of having in their territorial waters the world's largest natural gas deposit, the North Field—900 trillion cubic feet of reserves, two-thirds the size (in oil barrel equivalents) of Saudi Arabia's reserves of crude.

Natural gas these days is extremely cheap: Crude sells at a 300% per-Btu premium to gas, almost double the average spread of the past five years. Qatar's gas is especially hard to monetize because it lies far from Europe and Asia. So the Qataris are now completing the last two of 14 plants, several of which are larger than any elsewhere in the world, that cool natural gas into a liquid that can be transported by ship to distant markets. And Royal Dutch Shell is aiming for an even more splendid alchemy with a $19 billion project that turns gas into liquid oil products such as jet fuel (page 54). These oil spin-offs fetch as much as $90 a barrel and form a hedge against low gas prices.

To achieve all this, Qatar has opened itself up to foreign investors with an enthusiasm rarely seen in the Gulf. Shell, ExxonMobil, Total, ConocoPhillips, and others have already spent more than $100 billion on Qatari energy projects, according to the U.S. embassy, with an additional $120 billion expected by 2020. Qatar retains the majority stake in most of these projects, ensuring it will profit from a near-tripling of oil and gas exports from 2005 to 2010, to a projected $67 billion by yearend, according to estimates by the International Monetary Fund. IMF analysts peg the growth in Qatar's gross domestic product this year at 18.5%.

Careful and deliberate may turn out to be winning qualities in the Persian Gulf of the 2010s. While Dubai's Sheikh Mohammed bin Rashid Al Maktoum is laboring to resolve a $109 billion debt crisis that is hobbling Dubai World and Dubai Holding, Qatar has been scoring in the financial markets. At the depth of the global crisis, the Qatar Investment Authority bought about 9% of Credit Suisse Group. Since then the value of Qatar's stake in the Swiss banking giant has jumped some 50%, to $4.6 billion. Qatar also made a killing in shares of British banking group Barclays, netting about $1 billion in profits when it cashed out part of its stake. With Credit Suisse, the Qataris are underwriting $1.2 billion of Prudential's rights offering, which will help finance the British insurer's purchase of American International Group's Asian insurance operations. And




Sheikh and Sheikha: Their foundation has brought in Western schools

although Qatar's property market is quite soft, this inconvenience has cost the government just $7 billion in bank bailouts costs, a fraction of the likely final tab for Dubai.

The differences between Dubai and Doha run deeper still. Qataris keep nightlife restricted, have no interest in becoming a hub for mass tourism, and regret the loss of their past as fishermen and pearl divers. While Dubai has been racing to a western clock, Doha still does things in its own good time. Qataris continue to cherish the old custom of the *majlis*, the evening get-togethers where men (and only men) sip tea, smoke *shisha* tobacco, and solve the problems of the world through endless discussion. Grahame Maher, head of the local Vodafone operation, had to master this age-old routine before he could win over the Qataris. Says Maher: "I learned a way to do business that we have forgotten in the West because it takes too much time."

Qatar is trying to invest its riches in human capital, the sort of initiative that, throughout the Gulf, seldom seems to make the leap from glossy brochure to hard reality. Qatar's Sheikh Hamad bin Khalifa Al-Thani, a big, affable man who overthrew his father in 1995, set up the Qatar Foundation that year to turn Qataris into financiers, engineers, and biotech specialists. The sheikh's wife, Sheikha Moza bint Nasser Al Missned, runs the foundation, whose green-tree logo is ubiquitous.

The foundation has persuaded some quality schools to establish Qatar campuses. Weill Cornell operates a medical school, Texas A&M churns out petroleum engineers, and Georgetown has a liberal arts program that graduated one of the ruler's sons. Virgin Health Bank, part-owned by British entrepreneur Richard Branson, has the sheikha's backing to establish a stem cell bank. Virgin Health CEO Rajan Jethwa wants to create a regional cell hub that attracts biomedical research firms. "There is no more powerful motivator than being part of the Qatar Foundation," he says.

It's too soon to say whether these ef-

TOM STODDART/REPORTAGE BY GETTY IMAGES; CHART BY DAVID FOSTER/BW

forts will pay off. Like most of the Gulf, Qatar is short of qualified people and has to attract them from outside – far from a sure thing. Some U.S. universities here have struggled to fill their classrooms with qualified applicants. "The high-tech diversification requires not only people but a massive development of human capital overnight," says Rachel Ziemba, senior analyst at Roubini Global Economics in New York. Because of the difficulties in training workers, "Qatar should not be an industrial hub."

It won't be a financial one. Although the Qatar Investment Authority has had a string of hits, its Qatar Financial Center has attracted only token commitments from the big banks (Credit Suisse is the exception). In finance, "Qatar is not comparable to Dubai or even Bahrain," says Emad Mansour, deputy CEO of Qatar First Investment Bank. Nor has Qatar been immune to real estate disease. Its population has more than doubled over the past six years. Bets that the trend would continue prompted overbuilding that drove prices and rental rates down 25% last year, according to Century 21 Qatar, a branch of the U.S. real estate firm. The government projects a 50% population jump by 2030, which may prove optimistic. But that may not matter as long as the North Field yields its riches on schedule. Dubai, in the end, has many things that people want. Doha has something they need. |BW|

LIKE TURNING WATER INTO WINE

Shell's gas-to-oil project is over budget and hard to ramp up, but the payoff could be huge

By Stanley Reed and Robert Tuttle

Every morning red-uniformed Royal Dutch Shell engineers board buses at a residential compound in the suburbs of Doha, Qatar's capital. An hour later they reach Ras Laffan, an industrial area in northern Qatar, where they are greeted by a billboard of Sheikh Hamad bin Khalifa Al-Thani, the country's emir. The sheikh holds a glowing lamp. Above him is the slogan: Clean Energy from Qatar to the World.

Ras Laffan is the site of probably the largest single project in the global oil and gas industry. Shell is spending $19 billion on this facility, dubbed Pearl, to convert Qatar's near-endless reserves of natural gas to liquid oil products like jet fuel that fetch high prices. No one has attempted this process on such a scale, and Shell and its Qatari partners face a nail-biting rampup of the plant's many sections before everything is running full tilt. If they succeed, Shell thinks the plant may generate $6 billion a year in profits.

Andrew Brown, Shell's executive vice-president for Qatar, compares Shell's total possible production in the emirate, which includes a large liquefied natural gas plant under construction, to "creating a new Nigeria." That country supplies the Anglo-Dutch major with 10% of its oil and gas. Pearl may even wean Shell off its reliance on the West African state, where rebel attacks have hampered operations.

Shell project engineer Willem Keij says Pearl's startup this year will take months as unit after unit fires up. At the heart of Pearl will be 24 vessels, 1,200 metric tons each, filled with pipes where gas will be converted into paraffin, which will be broken down into kerosene for jet fuel, gas oil for diesel, and base oils for lubricants.



At the Pearl plant in Ras Laffan, getting ready to convert gas to liquids

Since the fuel Pearl will produce is purer than traditional crude-based products, Shell hopes to sell it at a premium. The process strips out pollutants such as sulfur, resulting in clean jet fuel for green-minded airlines and scrubbed diesel for cars. (The Pearl plant is energy-intensive, however, and its products still release carbon into the atmosphere.)

Construction has been costly: Shell's $19 billion bill is already three times the estimate. At least the raw material, natural gas, comes from the project's own wells and costs little. An oil refinery, in contrast, may need to pay $80 for a barrel of crude before it starts processing it into diesel or kerosene. "Gas-to-liquid makes sense when there is a spread between oil and gas prices," says Ross Cassidy, an analyst at Edinburgh-based Wood Mackenzie.

Pearl's web of pipes and tanks sprawls across 4 square kilometers, or 1.5 square miles. Some 51,000 workers, their necks draped in cloth to ward off the Gulf sun (temperatures can reach 125F), weld joints, dig ditches, and direct traffic. The project won't be ready to produce flat-out until 2011. "GTL is a very expensive process," says Iain Armstrong, an analyst at brokers Brewin Dolphin in London. "But the result you get is fantastic." |BW|



"I thought at my age there was nothing I could do about it, then I had 'the talk' with my doctor."

Your Doctor Talks to Men About ED Every Day



Doctor portrayal.

Your doctor will tell you that there is something you can do about your erectile dysfunction (ED). In fact, millions of men over 40 have already taken the first step and talked to their doctor about ED. And so can you.



Need Some Ideas on How to Open Up to Your Doctor?

The hardest part about having 'the talk' is getting those first few words out. Here are some ideas to help you break the ice when your doctor asks how everything's going:

The Direct Approach:
"I have trouble sometimes in bed. Could it be ED?"

The Indirect Approach:
"Is it true age affects sexual performance?"

The Silent Approach:
Just hand this ad to your doctor, he'll take it from there.

Running the Numbers

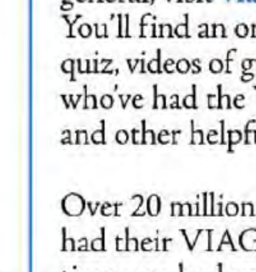
Did you know half of all guys over 40 have some form of ED? Here are some numbers to keep in mind from a recent survey of men with ED:



of men were anxious about talking to their doctor about ED.



of men felt relieved after talking to their doctor.



Tell Me More

To learn more about VIAGRA for the treatment of ED, and ED in general, visit **viagra.com** today. You'll find an online sexual health quiz, videos of guys with ED who've had the VIAGRA Talk and other helpful information.

Over 20 million men have already had their VIAGRA Talk. Isn't it time you had yours?

Important Safety Information

We know that no medicine is for everyone. Don't take VIAGRA if you take nitrates, often prescribed for chest pain, as this may cause a sudden unsafe drop in blood pressure.

Talk with your doctor first. Make sure your heart is healthy enough to have sex. If you have chest pain, nausea, or other discomforts during sex, seek medical help right away.

In the rare event of an erection lasting more than four hours, seek immediate medical help to avoid long-term injury.

In rare instances, men who take PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision, or sudden decrease or loss of hearing. It is not possible to determine whether these events are related directly to these medicines or to other factors. If you experience any of these symptoms, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time.

VIAGRA does not protect against sexually transmitted diseases including HIV.

Please see Important Facts for VIAGRA on the following page or visit viagra.com for full prescribing information.

For free information, including questions to ask your doctor, call 1-888-4VIAGRA (1-888-484-2472).

VIAGRA®
(sildenafil citrate) tablets

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IMPORTANT FACTS

VIAGRA® (vi-AG-rah)
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IMPORTANT SAFETY INFORMATION ABOUT VIAGRA

Never take VIAGRA if you take any medicines with nitrates. This includes nitroglycerin. Your blood pressure could drop quickly. It could fall to an unsafe or life-threatening level.

ABOUT ERECTILE DYSFUNCTION (ED)

Erectile dysfunction means a man cannot get or keep an erection. Health problems, injury, or side effects of drugs may cause ED. The cause may not be known.

ABOUT VIAGRA

VIAGRA is used to treat ED in men. When you want to have sex, VIAGRA can help you get and keep an erection when you are sexually excited. You cannot get an erection just by taking the pill. Only your doctor can prescribe VIAGRA.

VIAGRA does not cure ED.

VIAGRA does not protect you or your partner from STDs (sexually transmitted diseases) or HIV. You will need to use a condom.

VIAGRA is not a hormone or an aphrodisiac.

WHO IS VIAGRA FOR?

Who should take VIAGRA?

Men who have ED and whose heart is healthy enough for sex.

Who should NOT take VIAGRA?

- If you ever take medicines with nitrates:
  - Medicines that treat chest pain (angina), such as nitroglycerin or isosorbide mononitrate or dinitrate
- If you use some street drugs, such as "poppers" (amyl nitrate or nitrite)
- If you are allergic to anything in the VIAGRA tablet

BEFORE YOU START VIAGRA

Tell your doctor if you have or ever had:

- Heart attack, abnormal heartbeats, or stroke
- Heart problems, such as heart failure, chest pain, or aortic valve narrowing
- Low or high blood pressure
- Severe vision loss
- An eye condition called retinitis pigmentosa
- Kidney or liver problems
- Blood problems, such as sickle cell anemia or leukemia
- A deformed penis, Peyronie's disease, or an erection that lasted more than 4 hours
- Stomach ulcers or any kind of bleeding problems

Tell your doctor about all your medicines. Include over-the-counter medicines, vitamins, and herbal products. Tell your doctor if you take or use:

- Medicines called alpha-blockers to treat high blood pressure or prostate problems. Your blood pressure could suddenly get too low. You could get dizzy or faint. Your doctor may start you on a lower dose of VIAGRA.
- Medicines called protease inhibitors for HIV. Your doctor may prescribe a 25 mg dose. Your doctor may limit VIAGRA to 25 mg in a 48-hour period.
- Other methods to cause erections. These include pills, injections, implants, or pumps.
- A medicine called REVATIO. VIAGRA should not be used with REVATIO as REVATIO contains sildenafil, the same medicine found in VIAGRA.

POSSIBLE SIDE EFFECTS OF VIAGRA

Side effects are mostly mild to moderate. They usually go away after a few hours. Some of these are more likely to happen with higher doses.

The most common side effects are:

- Headache
- Feeling flushed
- Upset stomach

Less common side effects are:

- Trouble telling blue and green apart or seeing a blue tinge on things
- Eyes being more sensitive to light
- Blurred vision

Rarely, a small number of men taking VIAGRA have reported these serious events:

- Having an erection that lasts more than 4 hours. If the erection is not treated right away, long-term loss of potency could occur.
- Sudden decrease or loss of sight in one or both eyes. We do not know if these events are caused by VIAGRA and medicines like it or caused by other factors. They may be caused by conditions like high blood pressure or diabetes. If you have sudden vision changes, stop using VIAGRA and all medicines like it. Call your doctor right away.
- Sudden decrease or loss of hearing. We do not know if these events are caused by VIAGRA and medicines like it or caused by other factors. If you have sudden hearing changes, stop using VIAGRA and all medicines like it. Call your doctor right away.
- Heart attack, stroke, irregular heartbeats, and death. We do not know whether these events are caused by VIAGRA or caused by other factors. Most of these happened in men who already had heart problems.

If you have any of these problems, stop VIAGRA. Call your doctor right away.

HOW TO TAKE VIAGRA

Do:

- Take VIAGRA only the way your doctor tells you. VIAGRA comes in 25 mg, 50 mg, and 100 mg tablets. Your doctor will tell you how much to take.
- If you are over 65 or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg).
- Take VIAGRA about 1 hour before you want to have sex. VIAGRA starts to work in about 30 minutes when you are sexually excited. VIAGRA lasts up to 4 hours.

Don't:

- Do not take VIAGRA more than once a day.
- Do not take more VIAGRA than your doctor tells you. If you think you need more VIAGRA, talk with your doctor.
- Do not start or stop any other medicines before checking with your doctor.

NEED MORE INFORMATION?

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- Go to **www.viagra.com or call (888) 4-VIAGRA (484-2472).**

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CAUTION: STATS MAY BE SLIPPERY

WHY CLAIMS OF AN ALMOST MIRACULOUS DECREASE IN U.S. WORKER INJURIES DON'T STAND UP TO SCRUTINY

By Ben Elgin

Photograph by Billy Delfs



Adkins battled AK Steel in court over a shoulder injury

Peril permeates a steel mill. Molten metal explodes when exposed to water. Overhead cranes hoist steel coils weighing up to 80,000 pounds. Heavy vehicles roll within feet of high-voltage wires. "We have a work environment that presents every hazard known to man," says Alan H. McCoy, vice-president and spokesman at AK Steel in West Chester, Ohio.

In the face of these challenges, AK Steel last year achieved what appears to be the nearly impossible. The company, which had sales of $4 billion, recorded only 15

injuries among 6,500 employees—its safest year ever. Between 1994 and 2009, it slashed annual injuries reported to the federal government by 96%. According to data compiled by the U.S. Labor Dept. it is more dangerous to serve coffee at Starbucks or count currency as a bank teller than it is to maneuver massive metal slabs at AK Steel.

Across industrial America, employers are making extraordinary assertions about safer conditions for the nation's 14 million factory workers. The overall rate of injuries has fallen 48% in a decade. "Employers are doing more to improve workplace safety," says Marc Freedman, executive director of labor law policy at the U.S. Chamber of Commerce in Washington.

Now, however, the Occupational Safety & Health Administration, which until recently also praised the claimed improvements, admits to having second thoughts. "The statistics we have on workplace injuries are incomplete and, in some cases, inaccurate," says David Michaels, the newly appointed Assistant Secretary of Labor who heads OSHA. Suspecting that safety achievements may have been exaggerated at some industrial companies, his agency is stepping up investigations to identify bogus injury numbers.



OSHA's Michaels: The agency is going after questionable accident numbers

Michaels' suspicions were fueled by a report critical of OSHA issued in November by the Government Accountability Office, a nonpartisan congressional research agency. Based on interviews with physicians, occupational health experts, and others, the GAO found that some employers underreport injuries to reduce insurance premiums. Without identifying particular companies, the GAO also found that some workers fail to report broken arms and gashed legs because they fear being fired—a concern intensified by difficult job market conditions. As of last year, "OSHA's efforts to verify the accuracy of the data [were] not adequate," the GAO concluded.

48%

Reduction in manufacturing-related injuries and illnesses, 2008 vs. 1998

Data: U.S. Labor Dept.

Susan Baker, a professor at the Johns Hopkins Bloomberg School of Public Health and a scholar of workplace injuries, agrees that safety improvements appear to have been overblown. "It is extremely unlikely that injury rates would plummet like this," she says.

About 1.5 million U.S. companies with 10 or more employees must report work-related injuries and illnesses to the government if they require more than minimal first aid. Without accurate reporting, OSHA can't readily identify potential hazards, possibly leading to broader risks for more workers.

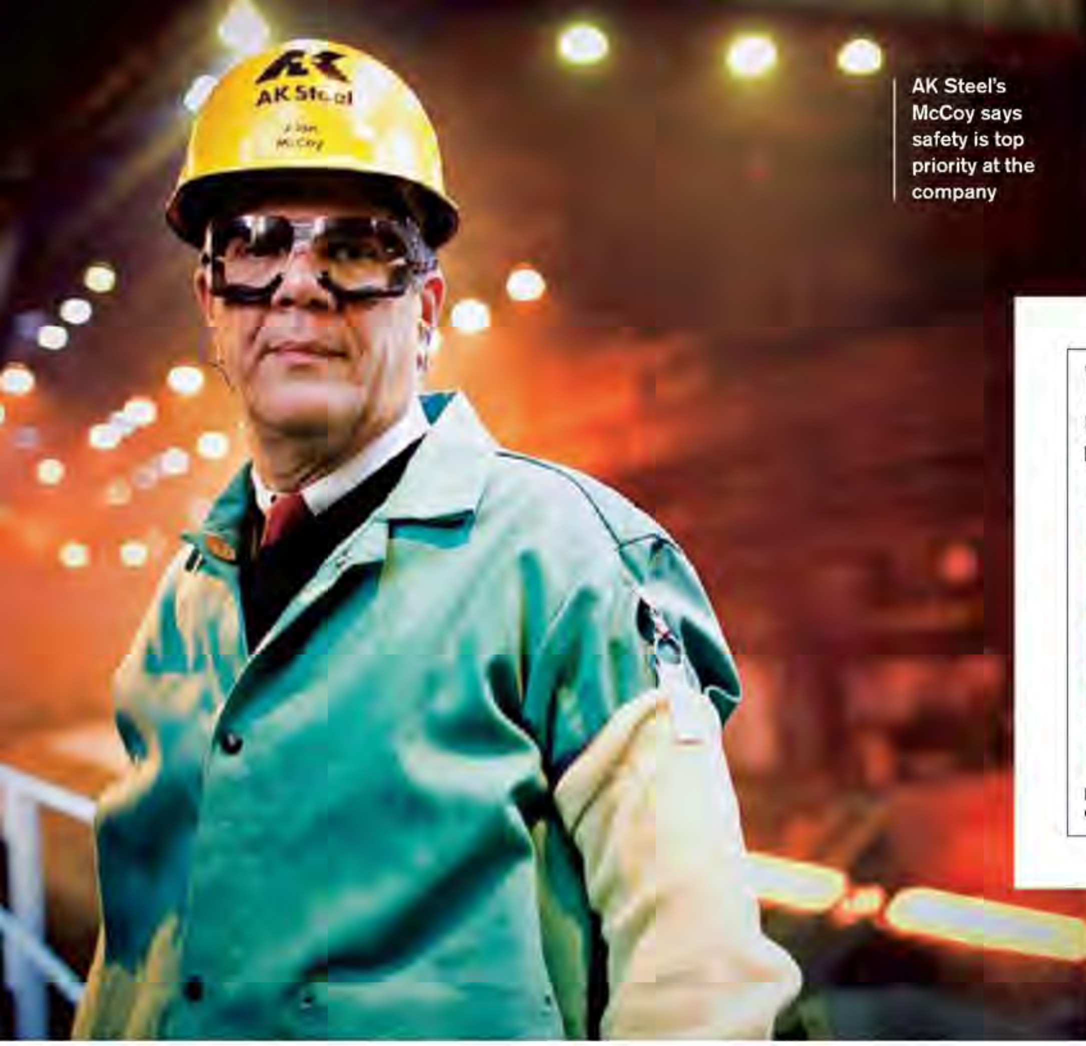
That's what some union leaders allege is going on at Caterpillar, the $32 billion maker of construction equipment based in Peoria, Ill. On paper, Caterpillar has trimmed its rate of workplace injuries by 81% since 2003. "We believe all accidents and injuries are preventable, therefore our goal for these is zero," the company says on its Web site.

The United Auto Workers, which has an acrimonious history with Caterpillar, counters that a lot of the improvement stems from the company's tendency to punish workers who say they were hurt on the job. "The extent of Caterpillar's blame-the-worker safety program is frightening," the UAW Local 974 newsletter asserted in its December 2008 issue. The local represents workers at Caterpillar's Peoria plant. "This unacceptable practice is carried out for one reason only—to intimidate workers and 'improve' safety statistics," the union newsletter added.

Asked about the union allegations, a Caterpillar spokeswoman said in a written statement that the company "is committed to the health and safety of our employees." The statement added that Caterpillar has "made improvements to our post-injury investigation processes to fully identify the root cause of injuries, accidents, and near misses, and [has] increased the sharing of best health and safety practices across the company to leverage the lessons learned."

AK Steel presents another case study of questionable safety claims, according to some current and former workers. The

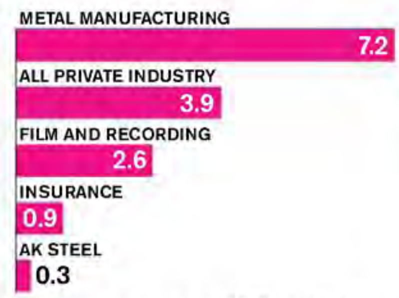
STEPHEN VOSS



AK Steel's McCoy says safety is top priority at the company

WORKPLACE RISKS

U.S. job-related injuries and sicknesses per 100 full-time employees:



Data: Company reports and U.S. Dept. of Labor data for 2008

company instituted new safety policies after 10 fatalities at its facilities from 1993 through 1996 led to an OSHA fine of $1.9 million. One side effect of this switch, the current and former workers say, was that some employees who reported injuries were cited for rule violations. "At the steel mill, you don't turn the small or medium injuries in, or else you get time off [without pay]," says Jeff Repper. He recently retired after working for 30 years at a variety of blue-collar jobs in the company's mill in Middletown, Ohio. "That's probably the biggest difference in the [injury] numbers," he adds.

Scott James, who also retired recently after 30 years at the Middletown plant, says that in 2001 he slipped on ice at the factory and fractured his wrist. When he returned with a splint the next day, he told his manager he had fallen at home. Three years later he suffered a leg burn the size of a silver dollar after molten metal splashed inside his protective clothing. Again, he opted to treat the wound on his own. "I didn't want to risk being punished," he says.

Asked about these accounts, AK Steel's McCoy says that not reporting an injury is an "extraordinarily serious offense" that can hinder the company from preventing other harm. "We find it not to be credible that someone would not report a serious injury out of fear of being disciplined," he adds. Five out of the 15 workers who had reportable injuries last year faced discipline to reinforce proper behavior, he says. "We make no apologies for our safety program and all of its components, including discipline." AK Steel spends millions of dollars outfitting employees with the most effective safety gear, McCoy says. Each mill has safety coordinators who receive suggestions from workers, and morning meetings start with a review of safety issues. "We have a total commitment from the very top of the organization that is demonstrated every single day," he adds.

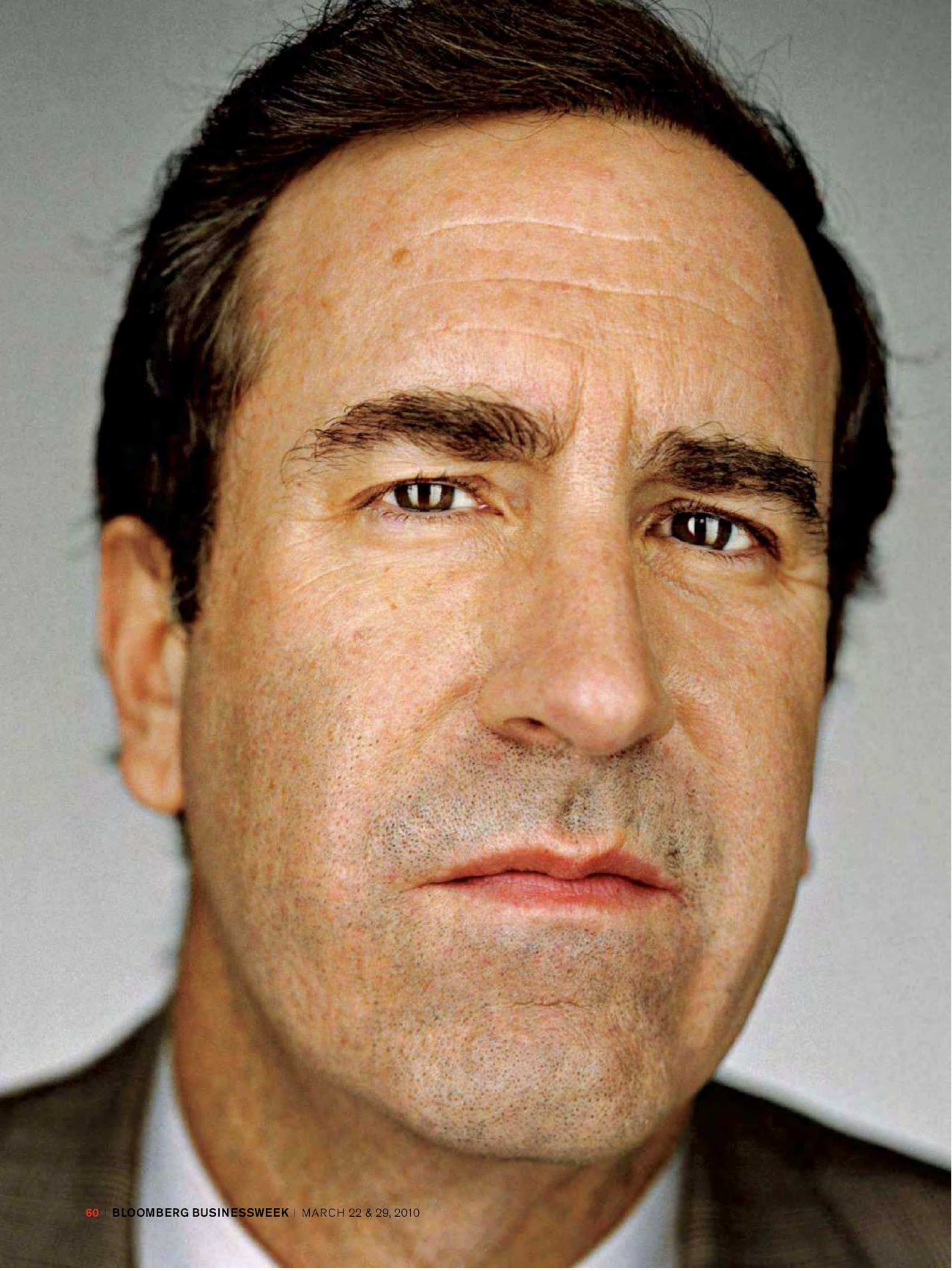
Injuries that workers do bring to the company's attention don't always get reported to OSHA, some current and former employees say. On Feb. 16, 2005, Beverly Adkins was unloading coal from railcars at AK Steel's Ashland (Ky.) plant. This task required her to swing a sledgehammer and lift heavy latches on railcar doors. Halfway through her shift, Adkins says, she felt a searing pain in her shoulder. She went immediately to the company infirmary. Later she was diagnosed with a torn rotator cuff and underwent surgery.

AK Steel determined that the injury was not work-related. Adkins hired a lawyer and challenged the company before a state administrative law judge in Kentucky. The judge sided with her, and the company appealed. In 2008, the litigation reached the Kentucky Supreme Court, which ruled against AK Steel. Frustrated by the years of legal wrangling, Adkins says she then settled with AK Steel under a confidential agreement requiring the company to pay her medical costs.

Despite four separate rulings that Adkins' injury had occurred as a result of work, her shoulder tear has never appeared on AK Steel's injury logs, which the company provided to *Bloomberg BusinessWeek*. "I couldn't understand how they would say the injury was not work-related," says Adkins, now 64.

AK Steel says it disagrees with the rulings and believes the underlying cause of Adkins' injury wasn't related to work. Because of this, McCoy says, AK Steel wasn't obliged under OSHA rules to report the injury. "Kentucky OSHA has reviewed our logs numerous times since that incident and has never raised a question," says McCoy. "If this is viewed as evidence that we are trying to manipulate our injury numbers, we would take offense to that." |BW|

PHOTOGRAPH BY BILLY DELFS; CHART BY ALBERTO MENA/BW



HOW I GOT THE GOODS ON MADOFF, AND WHY NO ONE WOULD LISTEN

Harry Markopolos and his ad hoc team of sleuths spent eight years trying to expose Bernie Madoff as a fraud —but the SEC turned a deaf ear. His new book tells the sad tale

"I'm a quant," writes Harry Markopolos. "I look at numbers the way other people read books." That ability allowed him to smell a rat in 1999 when he encountered the remarkable returns claimed for a secretive hedge fund run by Bernard Madoff, a renowned Wall Street broker-dealer. Markopolos and two colleagues at asset manager Rampart Investment began looking into Madoff's operation. They soon concluded he couldn't produce those results legally.

The following excerpt describes Markopolos' 2002 trip to Europe with Thierry de la Villehuchet, a French aristocrat who ran Access International, a New York firm that funneled money to Madoff. Markopolos already suspected Madoff was running a giant Ponzi scheme. As he and de la Villehuchet try to market an options-based trading product, Markopolos begins to understand the true dimension of Madoff's crime. On Dec. 23, 2008, less than two weeks after Madoff confessed to FBI agents, de la Villehuchet committed suicide.

BOOK EXCERPT

By Harry Markopolos

With Frank Casey, Neil Chelo, Gaytri Kachroo, and Michael Ocrant

Photograph by Martin Schoeller

We had 20 meetings in three countries in 10 days. It was a whirlwind tour of Europe. We met with various hedge funds and funds of funds. The meetings eventually ran together in my memory, but it seemed like each office or conference room was more luxurious than the previous one. The floors were covered with plush Persian carpets; the walls were done in rich walnut and cherry woods, and hung on many of them were oil paintings; we were served only with sterling silver, and the fixtures were gold. These rooms had been decorated to impress clients, to show them that money didn't matter—which they apparently believed was an effective means of convincing clients to give them their money.

We met with many of the leading

investment banks and private banks of Europe. The system there is quite different than here, as wealthy investors use private banks to conduct their business. I went to a meeting with members of the L'Oréal family. At JPMorgan I met with a member of the Givenchy family, who spent considerable time complaining about the Hermès family, who apparently were suing his family over an investment that had soured. At lunch one day with Prince Michel of Yugoslavia we sat at a table near Marc Rich, the disgraced financier whom Bill Clinton had so controversially pardoned. All these people knew each other. In Geneva, we were supposed to meet with Philippe Junot, the playboy who had been married to Princess Caroline of Monaco, but he canceled, I was told, because he thought my strategy was too risky, and he preferred to stay with Madoff.



Clockwise from left: De la Villehuchet; Markopolos testifying; Madoff going to court

(CLOCKWISE FROM TOP LEFT) GETTY IMAGES; MARIO TAMA/GETTY IMAGES; MCMULLAN.COM/SIPA

EUROPEAN EXPOSURE

Thierry began every one of our 20 meetings the same way: "Harry is just like Madoff. It's an option-based derivative strategy, only he offers a higher risk and a higher return. But it's different enough from Madoff that you should have him in your portfolio. If you have Madoff and you want some diversification, this will do it."

And every time he said it I got furious. What I wanted to shout out loud was that I was offering higher returns than Madoff because my returns were real and his were not. And I was a lot lower risk, because at most I was going to lose only 50% of their money while with Bernie they were going down a full load.

But I didn't. Instead I smiled and explained how this strategy worked. After that we would drill down to the details. I'd go through my pitch book. Then they would ask the usual range of questions: What are your risk controls? What are your trading rules? What is the frequency of the bad events that can hurt you?

It was the potential risk that scared them. I told them that way less than 1 percent of events could hurt the product, although admittedly should it happen it could be catastrophic. I was honest: "You could lose half your money very quickly."

The only fund that asked what I thought were the right questions about my due diligence was Société Générale. The people I met with there knew their derivative math. They told me, "We like your risk controls. You're the only guy who's ever come in here and specified what we can lose. But that risk is too high for us." Ironically, we found out in January 2008 that they actually weren't such good risk managers, as an employee named Jérôme Kerviel defrauded them of more than $7 billion by executing a series of elaborate, off-the-books transactions that circumvented the bank's internal controls.

These meetings generally lasted about 90 minutes, and Thierry would end each one the same way: "When can I have your answer? When shall I call you to find out how much you'd like to invest?" It was never "if you want to invest," always "how much." He was a master salesman.

While the objective of this trip was to introduce my product to these fund managers, it also turned out to be an extremely educational trip for me. I came back with a lot more knowledge about Bernie Madoff than I had expected—and what I learned changed my life.

My team had absolutely no concept of how big Madoff was in Europe. We assumed several European funds and funds of funds had invested with him, but we never appreciated the number of funds or the size of their investments. It became clear to me during this trip for the first time that Madoff presented a clear and present danger to the American capital markets—and to the reputation of the Securities & Exchange Commission (SEC). While obviously I had lost confidence in the SEC, I also knew that investors around the world believed that it offered them a great level of protection and that their money was safe. That was one reason they invested here. When they discovered that wasn't true, that confidence in the integrity of the American markets that led people to invest in them was going to be badly shaken. When Madoff went down, and that was inevitable, the American financial system was going to take a worldwide beating to its reputation. A primary reason to invest in the United States would have disappeared.

OF THE 20 MEETINGS WE HAD [IN EUROPE], THE MANAGERS FROM 14 OF THOSE FUNDS TOLD ME THEY BELIEVED IN BERNIE

Of the 20 meetings we had, the managers from 14 of those funds told me they believed in Bernie. Listening to them, I got



the feeling it wasn't so much an investment as it was some sort of financial cult. What was almost frightening was the fact that every one of those 14 funds thought that they had a special relationship with him and theirs was the only fund from which he was continuing to take new money. At first I thought the only reason they would admit to me, someone they didn't know at all, that Madoff was managing their money was because they trusted Thierry, but then I began to understand that they were telling me this to impress me. The message was practically the same in every one of those 14 meetings: "We have a special relationship with Mr. Madoff. He's closed to new investors and he takes money only from us."

When I heard that said the first time I accepted it. When I heard it the second time I began to get suspicious. And when I heard it 14 times in less than two weeks, I knew it was a Ponzi scheme. I didn't say anything about the fact that I heard the same claim of exclusivity from several other funds. If I had, or if I had tried to warn anyone, they would have responded by dumping on me. Who was I to attack their god?

"HE'S NOT A FRAUD"

What I did wonder about was what was going on in Thierry's mind. He heard these 14 fund managers bragging, literally bragging about this special access, just like I did, and he knew it was a lie just like I did. But we never discussed it. Like Frank [Frank Casey, one of Markopolos' colleagues], I had previously tried to warn him. Before we'd left for Europe I'd told him, in these precise words, "You know Madoff is a fraud, don't you?"

And just as he had done when Frank told him, Thierry became extremely defensive. "Oh no, that's not possible," he'd replied. "He's one of the most respected financiers in the world. We check every trade ticket. We have them faxed. We put them in a journal. He's not a fraud."

I had considered asking to see those trade tickets, knowing I could use them to prove to Thierry I was right, but I didn't. I was afraid that if I asked to see them he would think I was using them to reverse engineer Madoff, and I knew he wouldn't let me kill his golden goose.

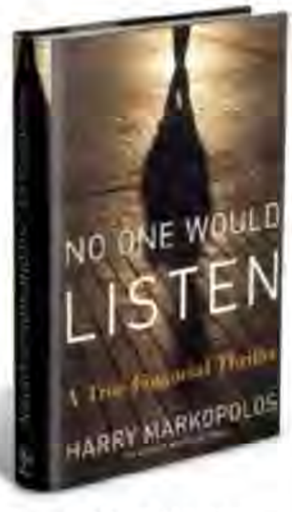
I cared about Thierry and I wanted to save him. After it had become clear that Thierry wouldn't listen to me, I called Access's director of research, who was a bright guy and understood derivative math, and told him that I had compiled a substantial amount of evidence proving Madoff was a fraud. "I get into the office at 6:30 in the morning," I'd told him. "If you'll come over half an hour early before tomorrow's scheduled meeting, I can prove to you mathematically that Madoff is a fraud."

He never showed up. And then I got it. He didn't want to know. Thierry didn't want to know. They were committed to Madoff; without him they didn't exist. It was their access to Bernie Madoff that allowed Access International to prosper. So when Thierry heard each of these funds claim an exclusive relationship, there was nothing he could do about it. It changed nothing. I also felt absolutely no obligation to tell any of the 14 asset managers that Madoff was a fraud. I had no personal relationship with any of them, and I certainly didn't want Bernie Madoff to know we were tracking him. Like Access, these funds needed Bernie to survive; they didn't need me. Where would their loyalty be? And what would

happen to me when Madoff found out I had warned them?

I did appreciate the fact that they were trapped. They had to have Madoff to compete. No one had a risk-return ratio like Bernie. If you didn't have him in your portfolio, your returns paled in comparison to those competitors who did. If you were a private banker and a client told you someone he knew had invested with Madoff and was getting 12% annually with ultralow volatility, what choice do you have? You're going to either get Madoff for that client or lose the client to a banker who has him. And Madoff not only made it easy; he made it lucrative. He allowed the feeder funds to earn higher fees than anyone else and always returned a profit.

That was the reason so many European funds gave their millions to him. It was after these meetings that I strongly suspected Madoff was even bigger in Europe than he was in the U.S. I estimated the minimum amount of money Bernie had taken out of Europe was $10 billion and in retrospect even that probably was low.



Excerpted from No One Would Listen, *by Harry Markopolos. Copyright ©2010 by Fox Hounds LLC. Reprinted by arrangement with John Wiley & Sons Inc.*

Once I realized how much money he had taken out of Europe—and was continuing to take—there was no longer any doubt in my mind that he wasn't front-running [that is, using his knowledge of transactions moving through his brokerage to trade ahead of them for his hedge fund clients]. This was a Ponzi scheme.

FEEDING THE MONSTER

For a Ponzi scheme to continue to survive you have to bring in new money faster than it is flowing out, because you're robbing Peter to pay Paul. The more Pauls you have to pay, the more Peters you need to find. It's a ravenous monster that needs to be continuously fed. It never stops devouring cash.

IT BECAME CLEAR TO ME THAT THE EUROPEANS BELIEVED [MADOFF] WAS FRONT-RUNNING—AND THEY TOOK GREAT COMFORT IN IT

But it became clear to me that the Europeans believed he was front-running—and they took great comfort in it. They thought it was phenomenal because it meant the returns were real and high and consistent and that they were the beneficiaries of it. They certainly didn't object to it; there was a real sense of entitlement on this level. To them, the fact that he had a seemingly successful broker-dealer arm was tremendously reassuring, because it gave him plenty of opportunity to steal from his brokerage clients and pass the returns on to them. They never bothered to look a little deeper to see if he was cheating other clients—like them, for example. What they didn't understand was that a great crook cheats everybody. They thought they were too respectable, too important to be cheated. Madoff was useful to them, so they used him.

They were attracted to Bernie like moths to a flame.

Just like the Americans, they knew. *They knew*. Several people admitted to me, "Well, of course we don't believe he is really using split-strike conversions. We think he has access to order flow." It was said with a proverbial wink and a nod—we know what he's doing. And if the American Madoff got caught, well, *c'est la vie*. They believed that the worst that could happen was that he could get caught and go to prison for a long, long time; but they would get to keep their ill-gotten returns and would get their principals back because they were offshore investors and the U.S. courts have no legal hold on them.

But for me, the most chilling discovery of this trip was the fact that many of these funds were operating offshore. It was not something that was spoken about; it was just something I picked up in conversation. Offshore funds are known as tax havens, places for people to quietly hide money so governments won't know about it. They're particularly popular in nations with high tax brackets, like France. While offshore funds certainly can be legitimate, to me it indicated that at least some of these funds were handling dirty money.

An offshore fund allows investors from a high-tax jurisdiction to pretend their income is coming from a low- or no-tax jurisdiction. While I have no direct knowledge, I definitely don't believe that all income from offshore tax havens is eventually declared to the proper government. But what was more frightening to me was the fact that offshore investments are used by some very dangerous people to launder a lot of money. It is common knowledge that offshore funds are used by members of organized crime and the drug cartels that have billions of dollars and no legitimate place to invest them.

For me, that suddenly added a frightening new perspective. It wasn't just the people in these luxurious offices who were going to be destroyed when Madoff went down; it also was some of the worst people in the world. I was pretty certain the Russian mafia had to be investing through one of those funds. I didn't know about the Latin American drug cartels, but I knew they went offshore and were probably into Madoff in a big way. Obviously Bernie had to be worried about a lot more than going to jail. These were men who had their own way of dealing with people who zero out their accounts. Maybe Bernie was close to being a billionaire—we had no idea how much of the money he was keeping for himself—but we knew that even he couldn't afford that. |BW|

A PONZI POSSE PRESSURES THE HILL

Victims of Madoff and Stanford are banding together

By Robert Schmidt and Jesse Westbrook

In the legislative scrum of Congress, winning means building a broad coalition. That's why victims of Bernard Madoff and accused Texas Ponzi schemer R. Allen Stanford are banding together to lobby for something neither group is influential enough to secure alone: a law that would help them recover some of their money.

Each group suffered losses that, for different reasons, aren't covered by the federal Securities Investor Protection Corp., which safeguards investment accounts against fraud or bankruptcy. Many of the Madoff victims are so-called "winners" who withdrew more money from the funds than they put in but want to be paid restitution for phantom returns they thought they were earning; the SIPC has refused to honor those claims. The Stanford victims aren't eligible for the fund, the SIPC says, because they bought their fraudulent securities from a foreign bank—Stanford's products were issued by a bank in Antigua—even though his firm had U.S. operations and made payments to the SIPC.

Realizing that a broader geographic base of support could improve their chance of success, investors defrauded by Madoff, mostly East Coast, Jewish, and backed by Democrats on the Senate Banking Committee, have linked up with the largely Christian, Sunbelt residents victimized by Stanford, who are supported by Republicans on the panel. Together, the groups hope to persuade the Senate to require brokerage firms to pay about $4 billion in additional fees to the SIPC, and to get the fund to grant them up to $500,000 each in compensation.

"We had been trying for a year, breaking our necks to get attention from Democratic members," says Angela Shaw, 40, of Dallas, whose family lost $4.5 million investing with Stanford. "Working together, maybe [we] will be heard."



Chaitman, a New York lawyer, lost her life savings to Madoff

EVAN KAFKA

Even after joining forces, the victims have a tough fight ahead. Stephen P. Harbeck, president of the SIPC, says his fund has enough money to cover all legally permissible claims up to the $500,000 maximum. "Speaking only for myself, I cannot see where it would be good policy to change the law to pay fictional, contrived investment profits in a Ponzi scheme," he says. The Senate Banking Committee has not met formally to discuss the compensation request; the House in December passed a measure without restitution.

In the Senate, the Stanford victims found support among banking panelists from hard-hit Southern states, including ranking member Richard Shelby (R-Ala.) and David Vitter (R-La.), says Shaw. She needed Democratic votes, so an aide to Vitter suggested she join forces with Helen Davis Chaitman, 68, a New York-based lawyer with Becker & Poliakoff who lost her life savings to Madoff and is leading the effort on behalf of her fellow victims.

Senate Banking Committee Chairman Chris Dodd (D-Conn.) is sympathetic to their cause, Chaitman says, as are Senators Charles Schumer (D-N.Y.), Jack Reed (D-R.I.), and Robert Menendez (D-N.J.).

Madoff pleaded guilty to a $65 billion fraud and is now serving a 150-year prison sentence. Stanford was indicted in June of defrauding at least 30,000 investors of $7 billion through a Ponzi scheme that sold allegedly bogus certificates of deposit. Stanford, in jail awaiting trial, denies the charges.

Chaitman, who started her campaign on behalf of 350 Madoff victims about eight months ago and has since met with more than 70 lawmakers or their staff, vows not to quit. "Someone has to stand up to Wall Street at some point," she says.

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FINANCE

Bull Market Believers

Three money managers who called the turn in March 2009 see big gains ahead; a fourth dissents



By Rita Nazareth and Whitney Kisling

Veteran money manager Laszlo Birinyi will never forget the moment a year ago when the last ounce of confidence disappeared. New York University Professor Nouriel Roubini and many other prominent pundits were convinced the economy was in free fall, and that the consequences for the stock market would be dire. To the 66-year-old Birinyi, who oversees about $300 million, the widespread pessimism was a clear sign that stocks were headed higher: "At turning points," he says, "the mood is always in one direction."

Birinyi says the 69% gain for the Standard & Poor's 500-stock index since the Mar. 9 low last year is just the beginning of a bull market that may last through the next Presidential election. Two other prominent market players who were bullish last March, Barton Biggs of Traxis Partners and Leuthold Group founder Steve Leuthold, share his optimism, saying stocks will advance as the economy gains momentum and the fastest corporate earnings growth since 1994 persuades investors to shift into stocks from bonds. It is far from a unanimous sentiment, of course. Another widely respected investor who anticipated the rally, Jeremy Grantham, chief investment strategist for Grantham Mayo Van Otterloo, now believes the market is overvalued.

$3.2 trillion

The amount of cash sitting in money market funds as of Mar. 3.

Data: ICI

President Barack Obama made his own stock market prediction last year, saying on Mar. 3 that buying U.S. shares "is a potentially good deal" for long-term investors. Six days later, the S&P 500 hit a 12-year low of 676.53 and then began its epic climb. For Obama, gains in stock and credit markets may be the clearest evidence that his policies are working, after losses tied to subprime mortgages spurred a financial crisis that erased $11 trillion in stock market value and sent the unemployment rate above 10%.

While investors have reason to celebrate, they are still a long way from breaking even. As of Mar. 10, the S&P 500 is 27% below the high of 1,565.15 set on Oct. 9, 2007, and trades at the same level it was at back in April 2005. For investors to get into the black, stocks would have to regain more than $5 trillion in value.

YOUNG BULL

Birinyi doesn't have a price target for the S&P 500, but he does say the rally may be a long one. The average bull market since the 1960s has lasted more than 1,000 trading days, data compiled by Bloomberg and Birinyi Associates show, while this one is just over 250 days old. And Birinyi expects this rally to be better than average because the deepest recessions give



Traders on the floor of the NYSE watch shares sink on Mar. 9, 2009

BRENDAN MCDERMID/REUTERS

way to the strongest bull markets. "By any definition it is a bull market, and there's no stronger force in the market than momentum," he says. His data suggest this bull run will last until at least April 2013.

Biggs, whose flagship hedge fund returned three times the industry average last year, says stocks remain cheap relative to forecast earnings. The S&P 500 is valued at 14.7 times 2010 profits, assuming earnings for companies in the index rise 27%, the average estimate from analysts tracked by Bloomberg. That compares with an average multiple of 16.6 over the last 56 years. Wall Street firms predict total income at S&P 500 companies will rise 50% in the next two years, the biggest increase since 1994, according to estimates compiled by Bloomberg. "I'm very struck by the level of bearishness everywhere I go," says Biggs, who predicts the next move in the S&P 500 will be a 10% to 15% gain. "I'm not obsessed with history. I'm bullish because I think the global economic recovery is on track and is going to be surprisingly strong. The world was falling apart in 2009. There's been a tremendous change."

The fact that investors remain skittish is one of the key factors encouraging Leuthold, who told clients to stop putting money into the firm's bearish fund on Mar. 4, 2009. Investors have pumped $369 billion into mutual funds that hold bonds since March 2009, compared with $23.4 billion for stock funds, according to the Investment Company Institute, the Washington-based lobbying group for professional money managers. "Individual investors, as measured by mutual fund flows, have absolutely no current enthusiasm for equity investing," Leuthold wrote in a Mar. 5 report to clients. "As a contrarian, I view this environment of disbelief and skepticism as quite bullish."

"BY ANY DEFINITION IT IS A BULL MARKET, AND THERE'S NO STRONGER FORCE IN THE MARKET THAN MOMENTUM."

That's because when skeptics regain confidence in stocks they will start pouring money into the market. And they have a lot of cash to play with. Investors fled to the shelter of money market funds as the financial crisis took hold in 2007 and 2008, and the $3.2 trillion that's in those accounts today means "there's still some money to be put to work," according to Mike Ryan, the head of wealth management research for the Americas at UBS Financial Services.

Of course, skeptics have plenty of reasons to keep their cash where it is. Unemployment remains high and the housing sector is still struggling—both factors that could keep a lid on consumer spending, which powers about 70% of the economy.

Jeremy Grantham is among those who see trouble ahead. Grantham, 71, whose firm manages $101 billion, says fair value for the S&P 500 is 875, or 24% below the Mar. 10 close. The figure is based on his calculation of historic price-earnings multiples, weighted to smooth out swings in profit margins. Grantham predicts that the deflating of the credit bubble will be a drag on the economy.

On Mar. 4 of last year, Grantham urged investors to move into stocks. What does he suggest today? "My recommendation to the typical investor would be to think outside the U.S.," Grantham says. "And when he thinks about the U.S., to be exclusively in defensive blue chips. The chances of a softening again—not a big collapse, but a secondary softening in the economy—are higher than the market believes." |BW|

Did J&J Plan to Break the Rules?

Its aggressive marketing campaign for Risperdal has caused an explosion of litigation



By Margaret Cronin Fisk, Jef Feeley, and David Voreacos

Johnson & Johnson's Risperdal was, in some ways, a drugmaker's dream. At its peak in 2007, the antipsychosis medicine produced $4.5 billion in revenues. But it has also opened up a medicine cabinet full of legal woes. Lawsuits are now pending against J&J in 10 U.S. states for promoting Risperdal "off-label"—meaning for uses the Food & Drug Administration did not approve. And in January of this year, the U.S. Justice Dept. sued J&J in a federal court in Boston, claiming the company paid kickbacks to Omnicare, the largest U.S. pharmacy for nursing home patients, to buy and recommend Risperdal and other drugs.

Documents from a lawsuit by the state of Louisiana accusing J&J of off-label marketing shed fresh light on the company's long-standing desire to broaden the market for Risperdal beyond the ailments listed initially on the label—psychotic disorders linked to schizophrenia. J&J disclosed the documents from the suit, filed in the Opelousas district court in Sept. 2004, after Bloomberg News asked the court to unseal them. The case is scheduled to go to trial in September.

As early as 1994, the filings show, the FDA ordered J&J's Janssen Pharmaceuticals unit, which developed Risperdal, to stop making false and misleading marketing claims about the drug's superiority to competing medicines. In 1999 the FDA warned J&J in a letter that its marketing materials for geriatric patients, including brochures, journal ads, and letters, overstated Risperdal's benefits while minimizing its risks. The letter said J&J misleadingly implied that Risperdal had been found effective for illnesses such as bipolar disorder and elderly psychosis. Months later, J&J drew up a business plan that called for increasing Risperdal's market share in treatments for elderly dementia, aiming at $302 million in sales, the filings show.

"EGREGIOUS EXAMPLES"

Louisiana cited dozens of internal J&J files in its lawsuit claiming the company marketed Risperdal to the elderly and to children for unapproved, off-label uses. Professor Jerry Avorn of Harvard Medical School, who isn't involved in the case, says the papers add up to "one of the more egregious examples" of marketing drugs to vulnerable patients. Medical professionals know "that drug companies resort to unsavory practices to promote drugs," he says, but seeing the details of this campaign "is still pretty upsetting."

J&J, based in New Brunswick, N.J., denies engaging in off-label marketing, and has not reserved money for a settlement. The company says it will fight the lawsuit, in which Louisiana seeks hundreds of millions of dollars in fines and reimbursement of public funds spent on Risperdal. Louisiana "does not cite any evidence that Janssen made misrepresentations or engaged in off-label promotion of Risperdal," J&J said on Nov. 30, 2009, in court papers asking a Louisiana state court judge to dismiss the case. In an e-mail, a Janssen spokesman told Bloomberg: "The Louisana litigation should be decided on the body of evidence,

FEELING THE PAIN

Settlements related to promoting drugs for unapproved uses have been rising sharply

DATE	COMPANY	DRUG	SETTLEMENT
Sept. '09	Pfizer	Bextra (painkiller)	$2.3 billion
Jan. '09	Eli Lilly	Zyprexa (antipsychotic)	$1.4 billion
May '07	Purdue Pharma	OxyContin (painkiller)	$634 million
Oct. '05	Serona	Serostim (AIDS)	$704 million

Data: Bloomberg News

JOHN KUCZALA



including testimony, not the basis of excerpts from documents that could be selectively quoted."

U.S. laws give doctors a lot of leeway when it comes to prescription drugs. They can treat patients with any medicine as long as the FDA has deemed it safe and effective against at least one ailment. But it's illegal for drug companies to make false claims or to promote drugs off-label.

The court filings show Janssen sought to sell Risperdal for bipolar disorder, dementia, mood and anxiety disorders, and other unapproved uses. Janssen salespeople promoted the drug to doctors, nursing homes, Veteran's Administration facilities, and jails, and also gave materials to doctors about studies involving unapproved uses. Over time, the FDA did conclude that Risperdal was effective for several mental illnesses. In 2003, it approved Risperdal for bipolar disorder. Three years later the drug was cleared to treat symptoms related to autism in children and teens. Regulators also cleared it to treat bipolar children and teens in 2007. The drug was never approved for dementia.

ONE DOCTOR ALWAYS PLANTS A SHILL: "...IF I GET A QUESTION FROM THE AUDIENCE, I CAN THEN SPEAK OFF-LABEL"

Lawsuits tied to off-label marketing have proliferated in the past four years, and drugmakers have paid out some lush settlements. Last September, Pfizer agreed to pay the U.S. government and various states $2.3 billion for off-label promotion of its Bextra painkiller and other drugs. For antipsychotics alone, off-label settlements against Pfizer, Eli Lilly, AstraZeneca, and Bristol-Myers Squibb have mounted to more than $2.5 billion since 2006.

Resolutions reached in some of these cases do not bode well for J&J. Lilly's settlements with the U.S. government and more than 40 states for off-label promotion of its antipsychotic, Zyprexa, came to more than $1.6 billion over time. "It was this very conduct—marketing an atypical antipsychotic for dementia rather than for psychosis—that led to the $1 billion-plus settlement with Eli Lilly," says Patrick Burns of Taxpayers Against Fraud, a Washington organization that supports whistleblower suits.

A MARKETER IN THE HOUSE?

In all, J&J made more than 5,000 pages of documents public. The filings show that Janssen executives felt a strong need to broaden their marketing efforts shortly after Risperdal won FDA approval. "Schizophrenia represents only 35% of [antipsychotic] prescriptions," Ivo Caers, a Janssen executive, wrote in a 1994 report included in court papers. "Aggressive expansion of Risperdal use in other indications is therefore mandatory."

Like other drugmakers, Janssen hired doctors to speak at continuing medical education, or CME, programs. But to drive sales, it armed them with slides extolling Risperdal's effectiveness. "The content of the Speakers Slide Kit is driven by marketing as they are promotional in nature," says a January 2003 e-mail sent by Jeni Bastean, a Janssen executive. At a 2003 meeting, another Janssen executive praised the use of coached questioners at programs, according to a transcript.

A doctor identified in the transcript as Randy told Janssen employees that he signed a letter agreeing he would only talk about permitted uses of Risperdal. But Randy had a way around this: "I always plant a shill because if I get asked a question from the audience, I can then speak off-label." After this remark, Dr. Andrew Greenspan, an executive in Janssen's medical affairs department, said: "That's good practical advice."

CME meetings also aided Janssen's marketing of Risperdal as a geriatric drug, according to Lon Schneider, a psychiatry professor at the University of Southern California and a plaintiff's expert in the litigation. The common element to such meetings, Schneider wrote in his expert report, "was to promote the use of Risperdal and other Janssen products for elderly patients with dementia." |BW|



THE PLAIN DEALER/LANDOV

INNOVATION & TECHNOLOGY

The Quest to Boost Good Cholesterol

Cleveland Clinic's Steven Nissen is again pursuing a drug that will attack plaque by raising HDL

By Ellen Gibson

Dr. Steven Nissen, 61, has built a prominent career as chief cardiologist at the Cleveland Clinic. He has run trials that helped some lifesaving drugs win approval from the Food & Drug Administration. And he voiced doubts that proved prescient about other experimental medicines.

But Nissen's hunches don't always hit the mark. Twice, he tested new drugs designed to keep heart disease at bay by boosting "good cholesterol," and giant drugmaker Pfizer bet upwards of $2 billion that they would succeed. The strategy may yet bear fruit, but neither of these two drugs made it onto the market—leaving Pfizer with no heart medicine to replace its current $11.4 billion blockbuster, Lipitor, which faces generic competition in 2011.

Undaunted, Nissen is now running clinical trials on a third treatment—this one from Resverlogix, a small Canadian company with no commercial products. If its medicine, RVX-208, succeeds in reversing buildup of harmful plaque in blood vessels, it may grab a "substantial" portion of the $35 billion market for cholesterol drugs, says Simos Simeonidis, an analyst with Rodman & Renshaw in New York.

Nissen says he's "cautious but optimistic" about RVX-208. "Hope springs eternal," he says. "We need to keep trying to find an HDL-raising strategy that works."

Lipitor and RVX-208 work in very different ways. The former belongs to a class of drugs called statins, which lower production of so-called bad cholesterol, or LDL, by blocking an enzyme in the liver. RVX-208 helps the body make more of the good kind of cholesterol, which excels at removing its evil twin from plaque in arteries.

Studies have shown that people with naturally elevated HDL are less likely to suffer heart attacks or die from cardiovascular disease. Nissen and Resverlogix are hoping that artificially raising HDL will have the same effect. It's not a sure bet. People who take the B vitamin niacin, for example, often show higher HDL levels, but it's not clear this cuts heart-attack risk, says Stephen Kopecky, a cardiologist at the Mayo Clinic in Rochester, Minn.

Nissen ran tests on two HDL drugs that haven't made it to market. He's testing a third

Heart disease is the leading cause of mortality in the U.S., resulting in 632,000 deaths a year, according to the Centers for Disease Control & Prevention in Atlanta. In many cases the culprit is the buildup of fat, cholesterol, calcium, and other substances—collectively known as plaque—in blood vessels that supply oxygen to the heart.

Nissen is determined to find new weapons to fight this process, in part because LDL-zapping statin drugs are an imperfect fix. They only reduce the risk of heart attack and stroke by 25% to 35%, according to Nissen, who has no financial stake in Resverlogix. "We could put statins in the water supply and heart disease would still be the leading cause of death in the developed world," he says.

Yet the track record for HDL boosters is dismal. In 2004, Pfizer paid $1.3 billion to acquire Esperion Therapeutics. The prize was an HDL-boosting drug similar to RVX-208. A report Nissen published in 2003 showed the medicine reduced plaque in early-stage testing. But it proved difficult to produce, and Pfizer ended up selling it to another drugmaker last December

for just $10 million, plus additional payments should the drug hit certain clinical and sales milestones.

Pfizer also spent $1 billion on the compound torcetrapib, designed to raise good cholesterol by blocking an enzyme that breaks it down. Pfizer at one point projected $13 billion in annual sales for torcetrapib as the successor to Lipitor. But it halted development of the drug in December 2006 when results showed that, far from lowering the risk of death, the drug raised it by 60%. Pfizer shares plummeted the first trading day after the announcement, wiping out $21 billion in market value. It was a blow for the team at the Cleveland Clinic, too. "Nissen kind of got burned," says Kopecky.

Early trials of RVX-208 last summer went well, and a second phase of testing has begun involving about 400 patients. If these trials succeed, CEO Donald McCaffrey says he'll start a third and final round of testing, aiming to file for regulatory approval in 2015.

Resverlogix is in "detailed discussions" with several companies seeking to partner or license its medicine, says McCaffrey, though he declines to give names. Simeonidis, the analyst, says Pfizer, Merck, Novartis, and Roche are all plausible collaborators—or buyers. Prospective partners "may want to wait to see more data," he says. "Then again, there's such a huge potential they may be willing to take a flyer." |BW|

Four Ways to Raise HDL

APOA-1 Resverlogix's RVX-208 is aimed at increasing the body's production of this protein, which builds HDL

CETP INHIBITORS Now being tested by Merck and Roche, these drugs block enzymes that break down HDL

LXR AGONISTS Molecules that help remove more cholesterol from arteries, under development at Bristol-Myers Squibb and Exelixis

HDL MIMETICS Compounds that mimic HDL's beneficial action, under development at CSL and The Medicines Co.

Data: Company reports

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Invasion of the Guatemalan Chicken

Chicken chain Pollo Campero established a niche with immigrants in the U.S. Now it's hungry for more

By Michael Arndt

Carla Flores emigrated to Chicago from Honduras 27 years ago. Her husband, Eric Ruiz, moved from Guatemala. He never forgot his favorite chicken back home—and for that Flores is thankful. We're talking about Pollo Campero, the fried chicken chain that's the McDonald's of Guatemala and making a dent in the U.S. fast-food market, with 53 stores in 15 states since its 2002 arrival. Flores and her daughter, Eugenia, drive a couple of miles to a Pollo Campero in Chicago three times a month just to get a taste. "It brings us back to Guatemala," says Eugenia.

Immigrants helped bring Pollo Campero to the U.S. Now, as part of the family-owned Guatemala City-based company's global goal of reaching 1,750 franchises over the next decade, the chain is expanding beyond its Spanish-speaking base in places such as Chicago, Los Angeles, and Washington. In the U.S. alone, Pollo Campero aims to grow tenfold, putting it on a collision course with established companies such as KFC and Church's Chicken, as well as rival up-and-comers like El Pollo Loco and Pollo Tropical.

Industry analysts say Pollo Campero should benefit from having U.S. franchisees in key markets who are veteran restaurateurs. They include Amir Siddiqi, a former chief operating officer of CKE Restaurants, which owns Carl's Jr. and Hardee's. Siddiqi's new company, Adir Restaurants, opened the first U.S. Pollo Campero in Los Angeles; sales hit $1 million within 22 days. Lawrence Levy, whose Levy Restaurants runs food concessions in 73 sports arenas and entertainment facilities, also bought in. His seventh store, opening this fall, will replace a McDonald's in Walt Disney World's entertainment district near Orlando. The company is also testing a restaurant inside a Wal-Mart store in Bentonville, Ark.

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CHRIS MATULA / PALM BEACH POST / ZUMA PRESS

Crossover dreams: A Pollo Campero outlet in Boynton Beach, Fla.

The chain is assimilating in part because its food is, too. While the U.S. menu still includes fried plantains and milky *horchata* drinks, it also lists dishes such as grilled chicken and mashed potatoes that are aimed at what Roberto Denegri, president of Campero USA, calls the crossover market. "Do I think they could have done this two decades ago? Probably not," says Blair Chancey, editor of food service magazine *QSR*. "But even in Middle America, tacos aren't foreign anymore."

Pollo Campero (the name means "country chicken") was born as an afterthought. Founder Juan Bautista Gutiérrez, who started out as a general merchandise retailer, opened his first restaurant in Guatemala City in 1971 as an outlet for his poultry farms. Now managed by two of his grandsons, the company and its franchisees operate 325 restaurants in 13 countries from Ecuador and Mexico to Spain, Bahrain, India, and China. Revenue hit $400 million last year, or almost a fifth of the $2.2 billion generated by the family's businesses, which range from flour milling and meat processing to lumber, construction, and hydroelectic power, says CEO Juan José Gutiérrez.

POLLO CAMPERO'S U.S. MENU INCLUDES FRIED PLAINTAINS, BUT MASHED POTATOES ARE ON THERE, TOO

The restaurants, which feature drive-through windows and brightly colored booths, will look familiar to many Americans. Pollo Campero boasts bigger-than-average checks in the U.S. because a high percentage of its customers are families. Per-unit sales come to $1.7 million a year, nearly double KFC's $950,000, estimates Darren Tristano, an executive vice-president at Chicago-based restaurant consultancy Technomic.

Prices tend to be higher than at many fast-food competitors, too. A 12-piece chicken combo—served family-style on platters with stainless steel flatware—goes for $21.99. That costs more than four foot-long sandwiches at Subway. But the chain just added budget snacks to the menu, starting at 99¢ for a chicken tortilla, with the tagline: More Campero for less *dinero*. Even crossover diners will get that. |BW|

BusinessWeek

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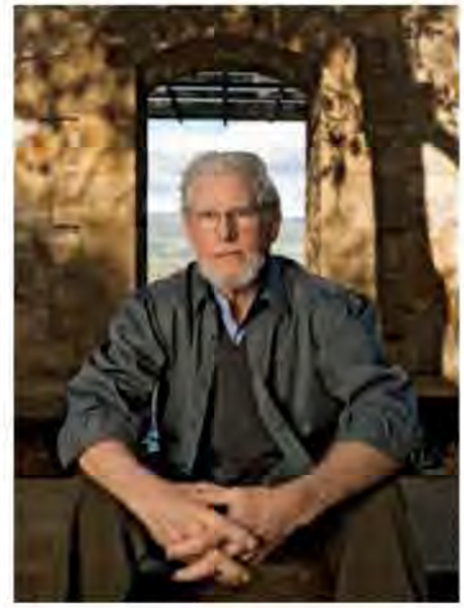
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Napa Valley's Grapes of Wrath

Falling land prices and changing tastes are turning 2010 into a vintage year—for winery foreclosures





CHIP CHIPMAN/BLOOMBERG (2)

By Dan Levy

That sound you hear is not the uncorking of a cabernet—it's the popping of California's wine country bubble. Crumbling land prices and a newfound popularity of cheaper wine may turn 2010 into a vintage year for Napa Valley foreclosures. As many as 10 premium wineries and vineyards in the area—home to the nation's priciest grapes—will change hands in distressed sales or foreclosures this year and next, according to an estimate by Silicon Valley Bank. (In 2008 there were none.) Property loan defaults in January were up fourfold from a year ago. Says Bill Stevens, manager of the bank's wine division: "We have 250 vintner clients saying this downturn is the worst in 20 years."

Suffering the most are newer arrivals, some of whom made their fortunes in real estate and finance. They piled in with visions of creating the next high-end label, buying land at the top of the market and saddling themselves with costs to match. Napa land values, which average $150,000 to $200,000 an acre for a vineyard planted with red varietals, have fallen 15% from the 2007 peak. Falling land prices, of course, make it harder to

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Harlan and a view from his winery: He grabbed a distressed parcel next door

refinance mortgages.

Adding to their woes is the sudden frugality of the American wine drinker. Between 1991 and 2008 the dollar value of U.S. retail wine sales rose every year, almost tripling in that time, according to consultant Gomberg, Fredrikson & Associates in Woodside, Calif. Last year sales dropped by 3.3%, to $29 billion, as prices were driven down by wine from Chile, Argentina, Australia, and elsewhere. (Chile's recent earthquake devastated many wineries but isn't expected to affect world prices, Gomberg Fredrikson says.) Rabobank Nederland, a Utrecht-based bank that finances agriculture, says sales of bottles priced above $30 fell at least 15% last year.

"No more is it about stocking wine cellars with 5,000 bottles of Screaming Eagle," says Peter Kaufman, managing partner of Bacchus Capital Management, a private equity firm in Pleasanton, Calif., referring to a Napa cult cabernet that can sell for $750 or more a bottle. "High-rollers are discovering that there are lots of drinkable $20 to $40 bottles of wine."

Now the strongest vintners are snapping up some bargains of their own. In December, Bill Harlan, who purchased his Oakville land in 1984, bought 21 acres next door known as Diamond Oaks Winery from businessman Dinesh Maniar. He's the owner of two other Napa parcels that face foreclosure, according to county land records and bankruptcy court documents. "In the long run," says Harlan, whose 2007 vintage Harlan Estate Proprietary Red sells for $500 a bottle, "those that manage their wines better and manage their land better will be fine." |BW|

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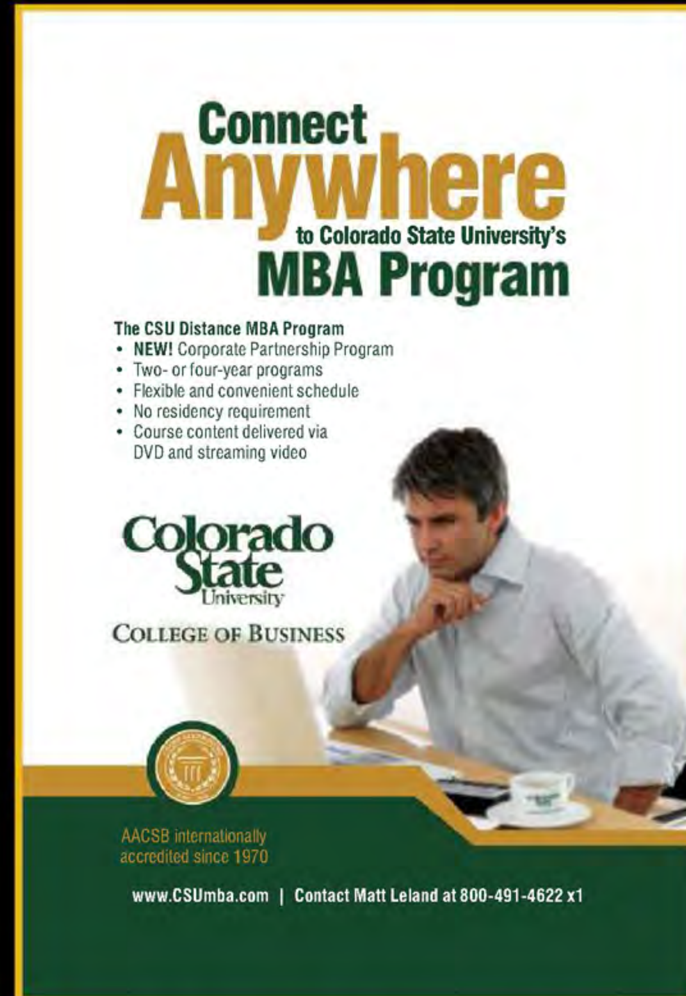
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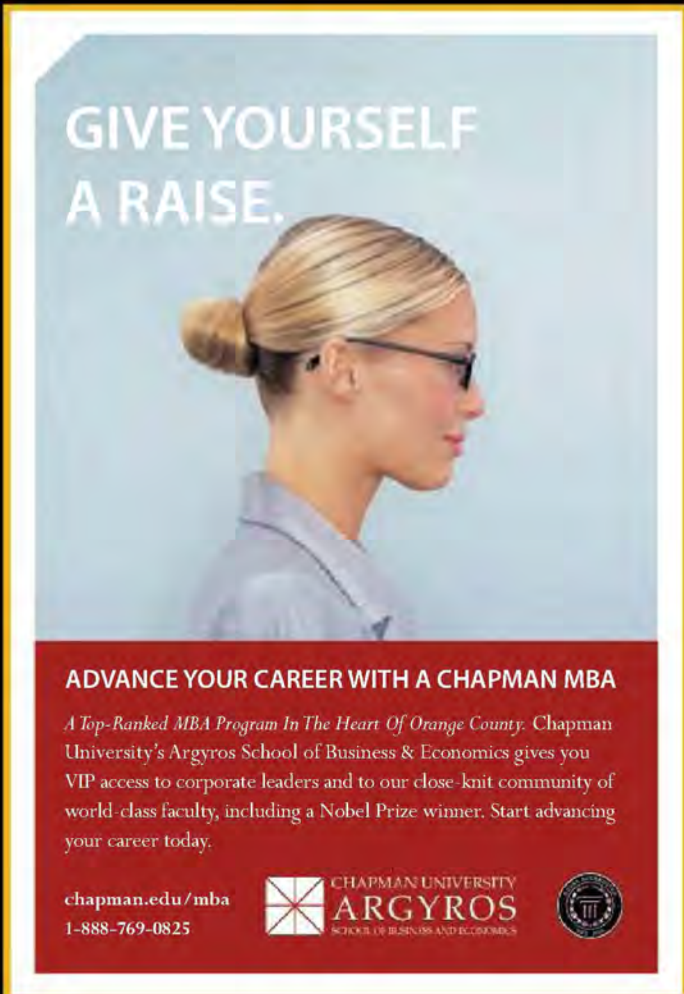


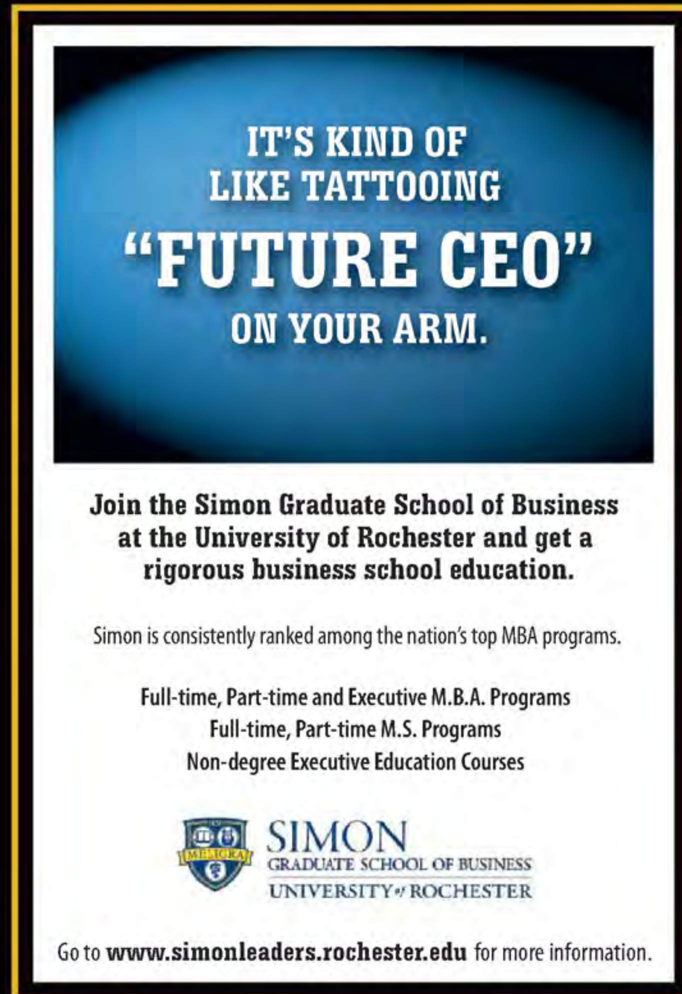
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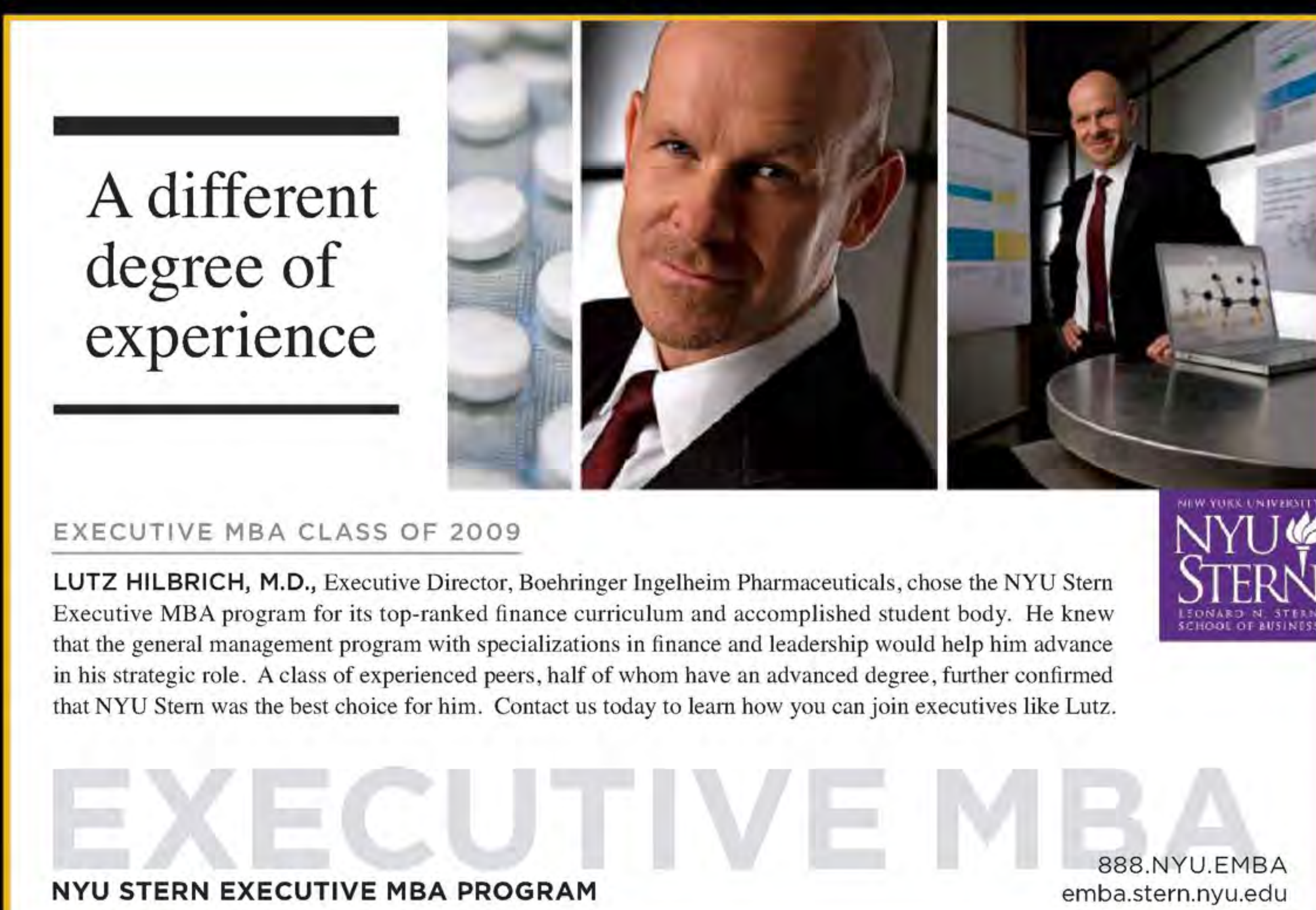
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The Spring 2010 Bloomberg BusinessWeek Executive Education & MBA Directory

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Bloomberg BusinessWeek

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PERSONAL BUSINESS

MONEY REPORT

HUNGRY FOR YIELD

Investors plowed $2.6 billion into global bond funds in the week ended Mar. 3, the biggest one-week haul in more than a decade, according to EPFR Global. And they pulled $30 billion out of money market funds. With the federal funds rate in a range of 0% to 0.25% for nearly 15 months, most money market funds now yield less than 0.1%. "Holding cash is a prohibitive strategy," said Tim Brunne, a Munich-based credit strategist at UniCredit. In contrast, the Barclays Capital Global Aggregate Bond Index has returned 9% since the Federal Reserve last lowered rates, in December 2008. Morningstar's favorite world bond offerings include Pimco's unhedged Foreign Bond Fund as well as the dollar-hedged Pimco Foreign Bond, which has lower exposure to currency fluctuations. Morningstar analyst Miriam Sjoblom explains that unhedged bond funds "offer a lot of diversification away from U.S. markets, but they come with a lot of volatility." Over the past year, the hedged Pimco fund returned 23%, and the unhedged version gained 33%. *–Tara Kalwarski, Bryan Keogh, John Detrixhe*

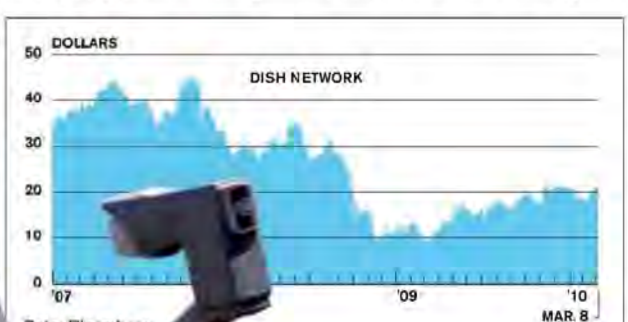
STOCKS

DISHING ON DISH

Shares of Dish Network fell by more than $1 on Mar. 4, to 20.59, after a U.S. appeals court ruled the satellite subscription service is still in violation of a TiVo patent. Dish argued that it had changed its technology enough to avoid infringement, but TiVo claimed the changes weren't sufficient; Tivo's shares are up 67%. The ruling may sound bad for Dish, but independent analyst outfit Collins Stewart reacted by upping its rating of the company's shares. It expects that most of the negative impact of the judgment is priced in and that shares could climb as high as 30 over the next 12 months. "We see this ruling as the last major obstacle because the company's fundamental turnaround is well under way," the report said. Analysts at Credit Suisse agreed, noting that closure on the litigation "is ultimately a good thing for Dish and should serve to remove an overhang on the shares." They estimate the stock is worth 25. *–T.K., Susan Decker, William McQuillen*



MATTHEW STAVER/BLOOMBERG NEWS



Data: Bloomberg

THE MARKETS

THE RALLY TALLY

The S&P 500 has climbed more than 68% since bottoming last March, the biggest 12-month gain since 1936. Share prices more than doubled for 205 companies—including Genworth Financial, which rose to more than $16, from a low of 84¢. Ten companies have the dubious distinction of losing value over the past year (table).

CHANGE IN SHARE PRICE OVER PAST YEAR	
MetroPCS Communications	-55%
GameStop	-19%
Dean Foods	-16%
People's United Financial	-9%
Apollo Group	-6%
H&R Block	-6%
MEMC Electronic Materials	-3%
Monsanto	-1%
Quanta Services	-1%
Dun & Bradstreet	-0.3%

Is there hope the rally still has legs? Among S&P 500 companies, the stocks of 456 are trading at 10% or more below their all-time highs, including Berkshire Hathaway, Alcoa, Tenet Healthcare, and Halliburton. Meanwhile, two dozen or so are at or near record highs, such as Apple, General Mills, Estée Lauder, and Ross Stores. *–T.K.*

HOW TO PLAY IT | LATIN AMERICA



(FROM PAGE 46)

By Tara Kalwarski

Latin America's stock markets were among 2009's top global performers. Many, including Mexico's Bolsa and Argentina's Merval, hit all-time highs in 2010. Such a rally may mean there is less room to run. Investments in the region tend to be heavy in the big countries, Brazil and Mexico, and big industries, energy, mining, and financials.



Data: Bloomberg

HOT FUNDS

Morningstar analyst William Samuel Rocco warns that Latin American stock funds probably can't maintain their strong performance—and "they're likely to suffer a number of blowups in the future."

BlackRock Latin America MDLTX

TOTAL RETURN



T. Rowe Price Latin America PRLAX

TOTAL RETURN



*Annualized Data: Bloomberg

TOP HOLDINGS IN BOTH INCLUDE:

America Movil AMX	This Mexican telecom gets 64% of sales from outside the country.
Itau Unibanco Holding ITUB	Shares of this Brazilian bank are down more than 7% so far this year.
Petroleo Brasileiro PBR	This energy giant makes up more than 15% of Brazil's Bovespa index.
Vale VALE	Based in Brazil, Vale produces and sells metals including gold and nickel.

SOUTHERN EXPOSURE

The SPDR S&P Emerging Latin America Exchange Traded Fund (above) invests in companies throughout the region. The ETFs below offer access to specific countries.*

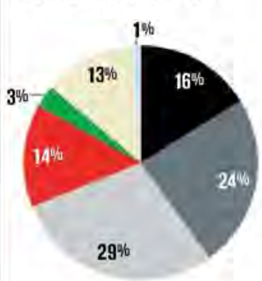
- BUSINESS AND FINANCIAL SERVICES
- CONSUMER GOODS AND SERVICES
- ENERGY
- INDUSTRIAL MATERIALS
- TELECOM
- UTILITIES
- OTHER**

iShares MSCI Brazil Index EWZ



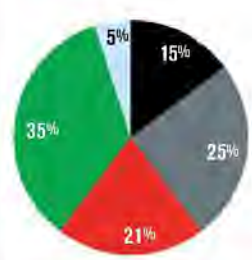
2009 return **122%** | 2010 return **-3%**

iShares MSCI Chile Investable Market Index ECH



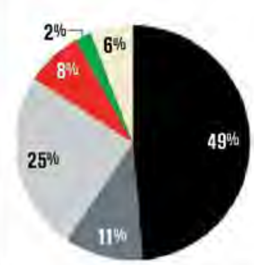
2009 return **86%** | 2010 return **6%**

iShares MSCI Mexico Investable Market Index EWW



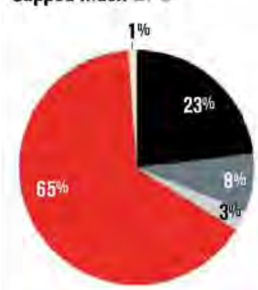
2009 return **54%** | 2010 return **4%**

Global X/InterBolsa FTSE Colombia 20 GXG



2009 return **N.A.** | 2010 return **16%**

iShares MSCI All Peru Capped Index EPU



2009 return **N.A.** | 2010 return **-2%**

CHARTS BY DAVID FOSTER/BW

*Pies may not equal 100 due to rounding; 2009 returns are not available for newly launched funds; 2010 returns as of Mar. 8 **Includes technology and health care Data: Morningstar, Bloomberg

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B-SCHOOL LIFE

GO EAST, YOUNG MBA

By Michelle Conlin



Crawford hopes he can capitalize on his Columbia MBA in Shanghai

RODNEY EVANS

James Tsai is the sort of MBA corporate recruiters covet. He went to a good prep school, earned a degree with honors from Middlebury College, and made vice-president in Bank of America's international wealth management group at the age of 26. Today, Tsai is about to graduate, straight A's in hand, from Northwestern's Kellogg School of Management, a top-rated program in America. And he's hustling to land his first post-MBA job—in China.

Executive Class strivers like Tsai used to have just one post-grad career destination, the U.S. Not anymore. "I am doing everything I think I can to get over there," he says.

Every era has its version of the MBA dream. In the 1980s, it was about conquering Wall Street and choppering off to the Hamptons. The late 1990s saw a stampede to Silicon Valley. In the mid-aughts, the gilded, clubby preserve of private equity beckoned. Now, the emerging narrative is about steroidal Asia and its promise of growth. At premiere institutions such as the University of Chicago's Booth School, the University of Pennsylvania's Wharton School, and Northwestern's Kellogg, the percentage of MBAs taking jobs in Asia—including U.S. students like Tsai as well as international students—has more than doubled in the past five years, from roughly 5% of the graduating class to more than 10%. "There is a sense that the center of gravity is shifting," says Julie Morton, Booth's associate dean for career services.

The number of students taking international jobs usually swells in a recession, says Kellogg Assistant Dean Roxanne Hori. But Hori and others believe that the refrain of "Go East, Young Man" is not a short-term response to the U.S. economic downturn but a structural shift toward an internationalized, mobile talent market. And right now, Asia is where the career velocity and opportunity are. "This has never really happened before, except in little spurts, where you have a fairly large group of talented, recent MBAs asking for assignments in China, Vietnam, India," says Jeff Joerres, CEO of global staffing firm Manpower. Adds Richard Florida,



professor at the University of Toronto's Rotman School of Management: "I don't think many of us thought Asia would become the destination for top Western talent—but it is."

ONE WORD OF ADVICE

For many MBAs, the prospect of making a bigger impact faster is simply too good to pass up, especially now that the pay packages offered by both domestic and multinational companies are competitive with those in the U.S. Shortly before James Crawford, 30, headed to Columbia B-School two years ago, his dad sat him down in the kitchen of the family's suburban Chicago home. Think of that scene in *The Graduate*, only instead of saying "plastics," Crawford's father's advice was "Asia." Today, Crawford is pursuing multiple opportunities there. "I can't imagine a career over the next 30 years that would not require or give benefit to international experience," he says. Asia fever has also hit Wharton student Andrew Maywah, 32, who had a cushy life working at Oracle in Silicon Valley before graduate school. Now he is juggling offers from three Chinese companies. "It's like the Wild, Wild West. There is just so much happening there," he says. "I want to be at the center of it."

IN ASIA, MBAs CAN MAKE AN IMPACT FASTER—AND PAY PACKAGES ARE COMPETITIVE WITH THOSE IN THE U.S.

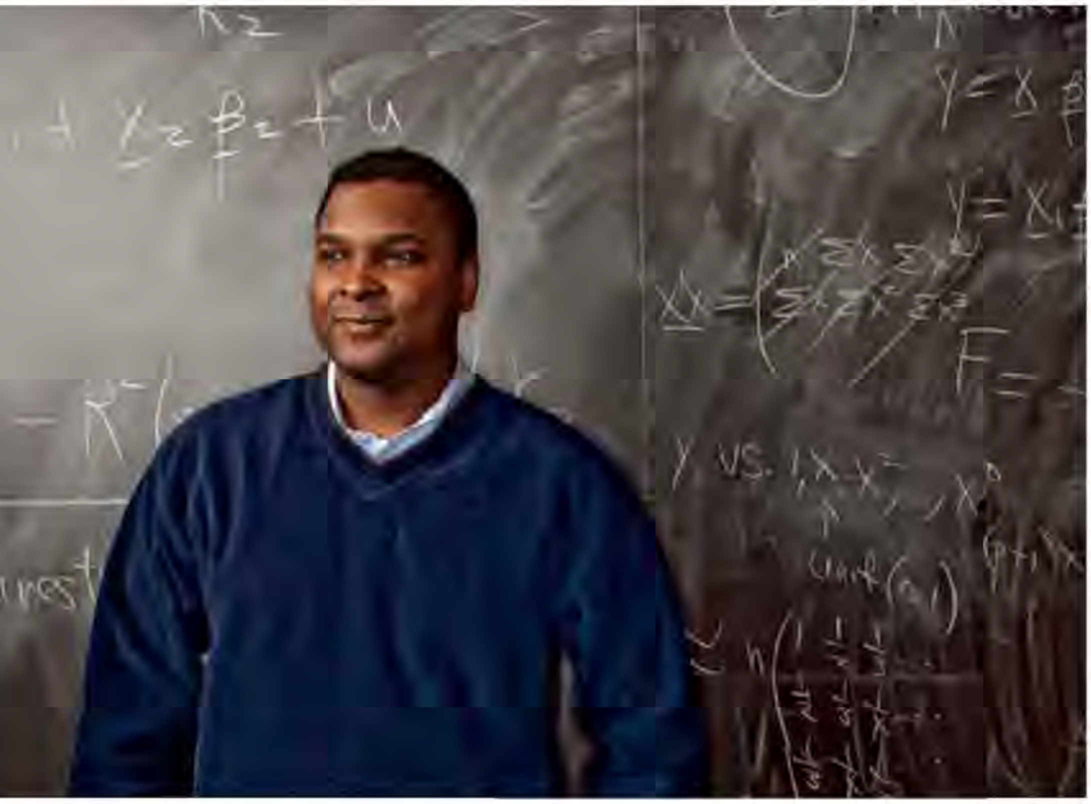
So do many Chinese who emigrated to the U.S. when they were young. They find themselves breaking the news to their families that they're chasing the same dream that lured their parents to the U.S., only in reverse. (What better time to leverage the family capital back in the old country?) The Chinese call these returnees *hai gui*, or sea turtles, referring to how these animals always return to their birthplace to lay their own eggs. Then there are the international students, who until recently would likely have stayed in the U.S. to learn the soft skills of Western management, and now are heading straight back home. Piyush Singhvi, 27, was born in India, grew up in the Middle East, and, before Wharton, worked at the Dubai-based private equity firm Abraaj Capital, the largest non-state-owned firm in the region. When Singhvi enrolled in Wharton in 2008 he was certain, he says, that he would stay in the U.S. after graduation like most of his peers. But then came the financial crisis. "It was amazing to see how many people came in with the idea that they would stay in the West, and how that's drastically changed to just the opposite," he says. "There are a lot more opportunities in the East."

On Facebook, Twitter, and Skype, MBAs swap stories about the adrenaline rush of working in an emerging market and the joys of geographic arbitrage. After graduating from Duke University's Fuqua School of Business, Quan Trinh, 27, who grew up in Virginia, took a job with Johnson & Johnson in Shanghai. There she partakes of an upper-crust-Manhattan-type lifestyle—food delivered to her door every night, a maid who picks up after her, a balcony apartment in a compound with a pool—at Albany (N.Y.) prices. Add to the mix that she travels around Asia with top J&J execs, working in the strategic planning division for the company's diabetes business, and, she says, "sometimes I have to pinch myself."

STANDING ROOM ONLY

Asian companies used to rarely, if ever, come to American B-school campuses for recruiting season. Now at Wharton, Chinese firms like heavyweight investment bank China Investment Corp. and IT firm Tencent are showing up, says Wharton global careers director Sam Jones. This year, CICC played to standing-room-only crowds. At Kellogg, India-based Infosys and Tata Group are now on hand for recruiting. The University of Chicago's Booth School is seeing so much interest from Chinese companies that it recently opened a career services office in Hong Kong.

South Korea's Samsung Electronics has been on a hiring tear. Last year the company signed 50 non-Korean MBAs from the top 10 business schools in the U.S., double the number of 2008, says Samsung Vice-President Kim Keun Bae. Those 50 were in addition to the dozens of



Maywah: "It's like the Wild, Wild West. There is just so much happening there"

ethnic Koreans that Samsung scooped up from MBA programs in America. At Kellogg, the company hired 16 business school graduates alone—more than U.S.-based hiring stalwarts General Mills and Procter & Gamble combined. The new hires work in Samsung's Global Strategy Group, which does all of its business in English, advising top Samsung executives on internal consulting projects. This year the company is on track to again double its hiring of U.S.-born MBAs. "The young and smart from top U.S. business schools have helped provide fresh perspectives to our company," says Kim. "Both foreign recruits and Korean employees learn from each other, and that helps globalize the company."

In many cases, companies like Samsung are acing out their American rivals in hiring the very best candidates. Kellogg graduate Jonathan Scearcy, 28, had 30 job offers last year, most from top U.S. companies. But he turned them all down to take a job at Samsung so he could "get international exposure early," he says. "If you ever want to be at a C-suite, you have to have a global skill set and you have to have significant international exposure," says Scearcy.

"GROOMING GLOBAL CITIZENS"

Multinationals like Citibank, Pfizer, Eli Lilly, and Nike China are also broadening their international programs and amping up hiring for their Asia divisions. Last fall a phalanx of high-level IBMers hit premiere B-schools to talk up IBM's new five-year boot camp for its general manager program. The program gives the new hires massive international exposure, especially in places like Asia. "We are looking to attract global citizens," says Peggy Tayloe, IBM's recruiting director. Big Blue recently flew the recruits to its Armonk (N.Y.) headquarters, where they sipped cocktails and nibbled canapés in the inner sanctum of the company's plush C-suite. One of the new hires hobnobbing at the party was Harvard MBA Yashih Wu, who was born in California and graduated from Princeton University. Before B-school, she worked on Wall Street and Madison Avenue. But for her those places aren't the career destinations they used to be. Today, she says, "It's impossible not to think globally about one's career."

How much longer can the Asian allure hold? With protectionist talk rising in America, and China trying to put the brakes on its rapidly growing economy, there's always a chance that Asia could stumble. There's also rising concern about what the migration East might mean for the U.S.'s competitive edge. "I can't get out of my head that two-thirds of Silicon Valley companies were started by non-U.S. citizens," says Manpower CEO Joerres. What if, after Stanford University, Google co-founder Sergey Brin had returned to his birth country of Russia? What if James Tsai is about to do the Next Big Thing—but in his dad's old country in Beijing? "The best and the brightest are leaving," says the Rotman School's Florida. "As a country, the U.S. has never confronted this before." |BW|

—With Moon Ihlwan in Seoul

"I CAN'T GET OUT OF MY HEAD THAT TWO-THIRDS OF SILICON VALLEY COMPANIES WERE STARTED BY NON-U.S. CITIZENS"

BILL CRAMER/WONDERFUL MACHINE

LIFE MANAGEMENT

B-SCHOOL LIFE

NO JOB? CREATE ONE

By Alison Damast

After six frenetic years, credit analyst Jennifer Wright watched her industry cool off overnight. What had been a bustling area prior to mid-2007—collateralized loan obligations—went into shutdown mode. Firms liquidated, investors grew leery, deals dried up, and suddenly "there wasn't any significant career potential," says Wright. It was a perfect excuse to go back to school. By January of 2008 she had enrolled in Columbia Business School's Executive MBA program with the aim of switching to another area of finance, like capital markets. But with Wall Street reeling and on-campus recruiting down, Wright, 39, decided to start a business of her own.

A friend's idea for a cleverly perforated pizza box, which divides into plates and a storage container, was the catalyst. Wright honed the "Green Box" idea (it's made of recycled materials) in entrepreneurship classes and entered it in B-school competitions across the country. By graduation last May she had seed funding and had decided to make a go of it. Says Wright: "The feedback I'd gotten was so incredibly positive I felt I'd be crazy not to pursue this."

MBA students who in years past may have easily snagged jobs in finance or consulting are turning to entrepreneurship as their plan B. At top schools like Columbia and the University of Michigan's Ross School of Business, record numbers of students are drawing up business plans. Driving the trend are risk-tolerant members of the millennial generation, ages 18 to 29, who are entering B-schools in droves but don't want traditional careers. "It's a sea change," says Thomas Kinnear, director of Michigan's Zell Lurie Institute for Entrepreneurial Studies.

One sure sign that entrepreneurship is taking off: surging interest in business plan competitions, where moguls-in-the-making present ideas to angel investors and venture capitalists. Applications for Rice University's MBA competition, which offers $800,000 in prizes and is the world's largest, are up 40%. Ross' Michigan Business Challenge had a record 85 applications, while submissions to the Wharton competition are up 22% this year.

One of the Wharton semifinalists is Brendan McCorkle, 29. He was laid off by Sunoco before starting school last August, and in school decided to focus on a business plan he and a friend had toyed with. The idea, Texturant, is software restaurants can use to alert diners via text message when tables are ready. Says McCorkle: "The economy galvanized my decision to work on it full-time." He's testing the concept at a Chili's in Burlington, Mass., and courting investors.

For some students, entrepreneurship isn't a lifeline but is a fallback. When Reed Shelger, 27, at Rice's Jesse H. Jones Graduate School of Business, couldn't find a summer consulting internship last year, he used his background as a former NCAA Division 1 college wrestler to open a wrestling and martial arts gym in Houston. Nearly a year later, he says the business is thriving. His career prospects have improved, too—he's fielding consulting job offers. "In hindsight, it couldn't have worked out better," he says. "I have the best of both worlds." |BW|



Jennifer Wright left Wall Street for a new life as a pizza packager

JARED McMILLEN

LIFE MANAGEMENT



Birch took a sabbatical from BlackRock to try farming. He's not going back

GRAHAM TROTT

SECOND ACTS

GREENER PASTURES

By Chanyaporn Chanjaroen

Graham Birch's knee-high boots are caked with mud as he climbs onto his tractor. His two dairy and sheep farms in southwest England cover 3,658 acres, an area more than five times the size of the City, London's financial district, where Birch worked for the last quarter-century in shoes seldom covered in anything but a shine.

In his job at BlackRock, which is headquartered in New York, Birch oversaw $36 billion and ran five commodities-related funds. Worrying about other people's pensions all day became exhausting. "It's not the hours themselves—it's the responsibility," says Birch, 49, who headed BlackRock's natural resources team for 11 years. The BlackRock Gold & General Fund, which Birch managed from 1999 until last year, was the top performer among 858 U.K.-domiciled mutual funds over the last decade, rising almost 23% annually, according to Morningstar. "At the peak we had $40 billion of people's savings. That's like a weight that pushes down all the time. I couldn't do that forever."

Success in finance had made Birch wealthy, but not content. So he traded it in for a world he knew little about. "I had never driven a tractor," he says. That was the point: "I needed a complete change." Now he has 560 dairy cows, 1,000 pregnant sheep, and a storage tank filled with 4 million liters (about 1 million gallons) of manure used for fertilizer. He


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LIFE MANAGEMENT

produces 3 million liters of milk a year, enough to fill an Olympic swimming pool.

Birch, who helped start and run a BlackRock hedge fund focused on agriculture, brings a money manager's sensibility to raising cows. "You can't be sentimental about it," he says. "These are adorable, but in a year we're going to sell them." With the guidance of Scott Bagwell, his 30-year-old farm manager who grew up a mile away as a son of a herdsman, Birch learned to drive a tractor. The farms have a total of six employees, and Birch sometimes helps with the afternoon milking. He makes his own cheddar cheese and sloe gin.

A sabbatical from BlackRock in April 2009 let Birch test the waters. He was supposed to return to the firm this year. In January he resigned instead. "I wanted to see whether I would miss the job and discovered I didn't miss it much at all," says Birch, who has a doctorate in mining geology from Imperial College London. "Fifteen years is long enough to do one thing. I've been to every Rio Tinto results presentation for, like, 25 years. I began to think I'm not learning anything new. If you stop learning new things, life becomes very, very boring."

His wife, Margaret Scribbins, 50, says the change has been good for the couple and their five children. They live in St. Albans, 126 miles from the farms in Dorset. Birch spends a few days a week at his farms—he has a cottage at the dairy farm. The family plans to stay in St. Albans until the youngest children, 13-year-old twins, finish school. Scribbins, an accountant by training, keeps the books. "He looks five years younger with the farm," she says of her husband, who has lost 14 pounds.

Birch hasn't completely abandoned his old life. He still holds some agricultural stocks, including Monsanto, the world's largest seed maker, and follows the mining news from a computer in his spartan office on the farm. He joined London-based gold producer Petropavlovsk last month as a nonexecutive director. If he ever went back to managing money, it would have to be a much smaller place than BlackRock, "where I could make a real difference as an individual," he says. He has no plans to do that, though.

The money Birch has poured into his farm includes 400,000 pounds ($609,300) for a grain storage building, 150,000 pounds for a new harvester, 50,000 pounds for new barns. He takes no salary and hopes to turn a profit this year. It may be a tough slog. The number of British dairy farms has fallen 54% since 1995, according to the Dairy Farming Information Centre, a nonprofit funded by milk producers. Prices paid to farmers were down 5% last year from 1995, data from the Department for Environment, Food & Rural Affairs show.

Birch predicts the market will turn. "As more of the farms get pushed out of the business, the farms that remain get the opportunity," he says. His larger one is 17 times the average size of farms in Britain. "As long as demand is there, which is the case for dairy products, then prices will go up. We've seen it in gold, copper. I think we're heading that way with agricultural business. That's why we got into agriculture. Prices have been too low for too long."

Birch's dairy cows are "adorable," he says, "but you can't be sentimental"



GRAHAM TROTT

Rising prices for U.K. farmland have made Birch's gamble a good bet so far. Since he first bought in southwest England in October 2007, prices have risen 28%, according to London-based property adviser Knight Frank. That's all well and good, but Birch has a different focus at the moment. "Two thousand lambs are going to be born over the four weeks" starting in late March, he says. "It is going to be hectic." |BW|


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97 Books: Pozen's *Too Big to Save?*
98 Tech & You: Your own private help desk
100 Outside Shot: Jack Bogle on corporate political contributions

BUSINESS VIEWS

BOOKS By MICHAEL OSINSKI

The Subprime Of Their Lives

In *The Big Short,* Michael Lewis lionizes speculators who made a killing on the crash

Twenty years ago, when I worked at Salomon Brothers, every person on Wall Street had read two books: Frank J. Fabozzi's *Fixed Income Analysis* and Michael Lewis' *Liars' Poker.* The latter was Lewis' debut, a devastating account of his four-year career as a bond trader at Salomon, which culminated in the crash of 1988. He has gone on to write best sellers on politics (*Trail Fever*), Silicon Valley (*The New New Thing*), sports (*Moneyball, The Blind Side*), and fatherhood (*Home Game*). The man, as they say, has range.

Still, Lewis is best known for writing about money and the people who will do anything to make it, so it's not surprising that two decades after leaving Wall Street he has returned to survey the scene of the latest crash.

The Big Short is a chronicle of four sets of players in the subprime mortgage market who had the foresight and gumption to short the diciest mortgage deals: Steve Eisner of FrontPoint, Greg Lippmann at Deutsche Bank, the three partners at Cornwall Capital, and most indelibly, Michael Burry of Scion Capital. They all walked away from the rubble with pockets full of gold and reputations as geniuses.

Short-sellers are usually cast as villains, but by pitting them against the deluded complacency of most in the finance industry, Lewis turns them into paragons of courage and virtue. Like all great storytellers, he loads the dice. We hear from the good guys' wives and learn plenty about the personal traumas they've overcome. The bad guys wear their hair slicked back and say stupid, venal things. Their wives were not interviewed.

If subtlety is scarce in *The Big Short,* the story is nevertheless told with a brisk and riveting style. Lewis does an extraordinary job elucidating the perils of shorting the very bonds that buoyed the American economy after September 11 and made a fortune for every firm on the Street. He also explains the arcane details of these securities with surprising fluidity. Lewis shows how the risky, subordinate bonds in structures of subprime mortgages (or "towers" as he calls them) were shuffled together to make the misunderstood and extremely unstable collateralized debt obligations (CDOs) and—hang in there folks, almost done—how insurance policies called credit default swaps (CDS) were created to short, or bet against, the CDOs and subprime structures. He only makes a couple of mistakes. Lewis refers to mezzanine bonds as the riskiest "floor" of the tower (they are in fact of much better quality than the absolute junk and nonrated pieces of paper that burn up first). He also confuses yield for coupon (a bigger problem, but not worth going into here). Still, not bad for a novice salesman 20 years removed from the business.

OFFERS OF MONEY

Strong as he is on exotic securities, Lewis is at his best working with characters. Burry is rendered most vividly. A loner from a young age, in part because he has a glass eye that made it difficult to look people in the face, Burry excelled at topics that required intense and isolated concentration. Originally, investing was just a hobby while he pursued a career in medicine.



Lewis is adept at making his characters vivid and colorful

TABITHA SOREN

As a resident neurosurgeon at Stanford Hospital in the late 1990s, Burry often stayed up half the night typing his ideas onto a message board. Unbeknownst to him, professional money managers began to read and profit from his freely dispensed insight, and a hedge fund eventually offered him $1 million for a quarter of his investment firm, which consisted of a few thousand dollars from his parents and siblings. Another fund later sent him $10 million.

Burry's obsession with finding undervalued companies eventually led him to realize that his own home in San Jose, Calif., was grossly overpriced, along with houses all over the country. He wrote to a friend: "A large portion of the current [housing] demand at current prices would disappear if only people became convinced that prices weren't rising. The collateral damage is likely to be orders of magnitude worse than any-

one now considers." This was in 2003.

Through exhaustive research, Burry understood that subprime mortgages would be the fuse and that the bonds based on these mortgages would start to blow up within as little as two years, when the original "teaser" rates expired. But Burry did something that separated him from all the other housing bears—he found an efficient way to short the market by persuading Goldman Sachs to sell him a CDS against subprime deals he saw as doomed. A unique feature of these swaps was that he did not have to own the asset to insure it, and over time, the trade in these contracts overwhelmed the actual market in the underlying bonds.

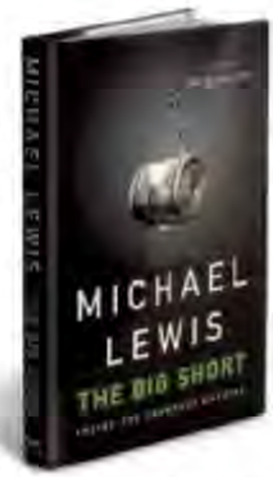
WINNING TICKETS

By June 2005, Goldman was writing Burry CDS contracts in $100 million lots, "insane" amounts, according to Burry. In November, Lippmann contacted Burry and tried to buy back billions of dollars of swaps that his bank had sold. Lippmann had noticed a growing wave of subprime defaults showing up in monthly remittance reports and wanted to protect Deutsche Bank from potentially massive losses. All it would take to cause major pain, Lippmann and his analysts deduced, was a halt in price appreciation for homes. An actual fall in prices would bring a catastrophe. By that time, Burry was sure he held winning tickets; he politely declined Lippmann's offer.

So Lippmann began shorting every mortgage-related instrument he could get his hands on, starting with subordinated bonds backed by subprime mortgages as well as the CDOs that bundled these bonds together. Wall Street firms had more or less duped the rating agencies into stamping even the most dubious of these concoctions with double-A and triple-A seals of approval.

Eisner worked with Lippmann to amass his own holdings of short positions. Meanwhile, Cornwall Capital, a tiny, unknown firm (derided by big firms as Cornhole Capital), made the riskiest moves of all, betting against the portion of CDOs that almost everyone in the business assumed were safe, short of full-on tanks-on-Park-Avenue apocalypse. Those assumptions, of course, proved wrong, and Cornwall's returns were spectacular.

Lewis does not let the mechanics of the process cloud the drama, and his renowned eye for color is as sharp as ever. He explores the trade shows in Orlando and Las Vegas where thousands of industry insiders gathered to pat themselves on the back, talk shop, and shoot Uzis. The unreal euphoria displayed at these shows (I attended them in the 1990s, renting a booth outside the halls to hawk my software) persuaded the short-sellers to double down on their bets.



The Big Short: Inside the Doomsday Machine **by Michael Lewis; W.W. Norton; $27.95; 288 pp**

As the house of cards teetered, Lewis lets his short-sellers toss barb after barb at the Wall Street Establishment: "This is a fictitious Ponzi Scheme." "Do they merely deserve to be fired or put in jail?" "There were more morons than crooks, but the crooks were higher up." All of these will surely be appearing in the movie version.

It wasn't entirely smooth sailing for Lewis' heroes, though. Burry, for one, saw the crisis forming so early that, as the reckoning kept getting pushed into the future, he struggled to hold on to his investors. After he ran up losses in consecutive years, he had to resort to questionable methods to retain his investors' money. If his assets under management dropped below a certain threshold, Goldman and American International Group could walk away from their swaps. Some of Burry's investors started entertaining litigation.

Even when default rates initially started rising, bond prices held firm. It wasn't until Jan. 31, 2007, that the index of subprime bonds suffered its first ever one-point drop. According to Lewis, that was the day "the market cracked." What Lewis fails to note is that the day prior, Lewis himself had filed a column for Bloomberg News from Davos mocking Nouriel Roubini's warning "that the risk of a crisis happening is rising." Such forecasts of doom came from "people with no talent for risk-taking gather[ed] to imagine what actual risk takers might do," Lewis wrote. The headline described them as "Wimps, Ninnies, and Pointless Skeptics." In *The Big Short*, Lewis recognizes he was wrong. The ninnies have inherited the earth. |BW|

Michael Osinski retired from Wall Street and now runs Widow's Hole Oyster Co. in Greenport, N.Y.



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BOOKS

By GEOFFREY MILLER

Defusing the Financial Time Bomb

Without tough reforms, we'll probably face an ugly repeat of recent history

Here's an offer: Invest a lot of money in a faltering project, and if things go well, you'll get your money back and maybe a little upside; but if it all goes south, you'll bear the entire loss. Not exactly the sort of terms to which anyone of sound mind would agree.

But this, says Robert Pozen, is exactly what the government signed on for in 2008—and more than just once—as the financial world swayed on the brink of collapse. In *Too Big to Save? How to Fix the U.S. Financial System*, Pozen, an eminent money manager and authority on financial regulation, rails against the waste and poor judgment that characterize many of the bailout deals of that year. His term for it is "one-way capitalism"—since only the banks were in line for real gains. And readers won't be able to mistake his disgust that the players who had taken the most foolish risks found themselves in the most advantageous spots.

ONE REFORM POZEN THINKS WE CAN DO WITHOUT IS THE REINSTATEMENT OF GLASS-STEAGALL

Government officials who would never have put their own money into deals such as the Troubled Asset Relief Program or the massive, sequential rescue of AIG had little difficulty placing taxpayer funds in jeopardy. Pozen thinks the government should have taken common stock in bailed-out firms so that it could fully participate in the upside.

While he applauds the government for having stepped up aggressively to avert a mass panic, he takes issue with its lack of forethought—and not only about those potential returns. The Treasury, the Federal Reserve, and the Federal Deposit Insurance Corp., he says, simply forgot about the issue of moral hazard. As a result, their interventions practically guarantee excessive risk-taking.

Unless some drastic steps are taken, Pozen sees the future as a very dangerous place. His list of recommendations—corralled in the last of the book's four sections and summarized in blocks of bold text (perhaps for busy politicians)—is long. And he pleads his case well, in a thorough but digestible fashion. He'd like to see FDIC coverage on bank deposits lowered to $100,000 from $250,000 to reduce risk to the agency and keep its protection focused on those who need it most. He favors creating a standard operating procedure for liquidating "systemically significant institutions," including mega-hedge funds, when they fail. One reform he opposes: the reinstatement of Glass-Steagall. Pozen says independent investment banks are more likely to stumble than integrated "universal banks."

Perhaps most interesting, original, and controversial are his recommendations for the governance of financial behemoths. The prevailing model of a large board—10 to 18 directors, few with experience in financial matters—just isn't working. As a result, Pozen says, compensation practices are out of whack, bonuses are outlandish, and control of risk-taking is virtually absent. He thinks these bloated boards should be replaced by a small number of "superdirectors" who have the time, experience, and financial incentives to act as effective watchdogs over complex institutions. A sound idea—and one CEOs would surely oppose.



Too Big to Save? How to Fix the U.S. Financial System **by Robert Pozen; John Wiley & Sons; $29.95**

Although mismanagement and moral hazard may be unavoidable, Pozen's prescriptions offer a navigable route to minimizing them. But since the ambitious reforms he calls for seem to be more than Congress can muster, reducing our national risk may be more than we can hope for. |BW|

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TECH & YOU

By RICH JAROSLOVSKY

Your Own Private Help Desk

India's iYogi promises to keep you up and running—but the hard sell grates

It's late at night, and technology is tormenting you. Something's wrong with your computer. Blood pressure climbing, you try your PC maker's tech support. They say the glitch has nothing to do with their stuff—it's somebody else's problem. Yours. What to do?

For many, the answer is a 24/7 online support service whose technicians take control of your computer remotely and try to fix what ails it. One of the best known is iYogi.net. Based in Gurgaon, India, it provides support to Wal-Mart PC buyers and sells its services through Wal-Mart.com, Amazon.com, and elsewhere on the Web.



If the thought of turning control over to someone you never met half a world away fills you with terror, it shouldn't. The techs are certified by Microsoft, Cisco Systems, and Hewlett-Packard, and the company seems to take ample steps to keep customers' data secure. But iYogi has rough spots, and costs mount if you let the company sell you add-ons.

Three Bloomberg journalists, myself included, signed up separately for the service, which costs $139.99 for one year. I tried several times to register online, using three different computers on three different networks. Each time, my registration was kicked back with an error message telling me it was an invalid transaction. Finally I used the live-chat feature on the home page to seek help. I eventually reached an iYogi representative by phone who transferred me to an automated system to take my credit card information—but not before subjecting me to a hard sell on a two-year plan for an extra $100. (He gave up after two or three tries.) The company later blamed the registration errors on a new fraud-prevention system.

When I phoned again that evening, a polite and professional technician walked me through the process of downloading and installing iYogi's support software, which includes tools for seeking help via real-time chat and requesting a telephone callback. I told the tech my computer was running slowly and gave him permission to take over. Then I sat back and observed.

The process went smoothly—with one exception. When I noticed he was downloading and installing an anti-spyware program, I interrupted to say I already had such software. He acknowledged my message, then attempted to install it two more times. Each time, I stopped the process. He desisted only when I sent a stern message saying I didn't consent to the download.

My two colleagues had similarly ragged experiences. One was trying to get his Windows PC to connect to an Apple wireless router. He too was subjected to entreaties to extend the length of service and, in his case, buy unneeded virus-protection software for $100. Then the tech wanted a number he said was printed on the router (it wasn't) and attempted, unsuccessfully, to reach Apple. After an hour, my colleague gave up and called Apple, where a tech got things working.

My other colleague ran into the same difficulties I did when she tried to sign up for the service—and suffered the same hard sell for the extended plan, which she took. Once she finally got set up, the technician was unable to help her because she couldn't find her original Windows XP disks. Her subsequent callback triggered a five-hour marathon that included several disconnected telephone calls, multiple reboots, miscommunication, apologies from iYogi, and, in the end, a Windows reinstallation that restored her computer to working order but cost her the data on her hard drive—something she could have accomplished on her own.

The iYogi technicians are as patient and polite as they can be, considering they're dealing with customers who already are agitated. But they really should cool it on pushing the two-year extended plan. First, show me you can provide value. Then we'll talk. |BW|

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For past columns and additional tech coverage, go to businessweek.com/technology/
E-mail the author at rjaroslovsky@bloomberg.net

PETER ARKLE

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OUTSIDE SHOT

By JOHN C. BOGLE

It's Time to Stand Up To the Supreme Court

The court's decision to let public companies spend freely on elections simply isn't fair to shareholders. But there's a way to push back

In January the U.S. Supreme Court ruled that laws limiting corporate political contributions were a violation of constitutional free speech principles. "The First Amendment confirms the freedom to think for ourselves," wrote Justice Anthony M. Kennedy in his 5-4 majority opinion, which is sure to unleash a flood of corporate spending on ads for and against political candidates.

But public companies aren't people. As Justice John Paul Stevens, writing for the minority, observed, the court committed a grave error in treating corporate speech the same as that of human beings. The notion that the same freedoms should apply when a public company, often with tens of thousands of owners, speaks in matters beyond the scope of its business affairs offends common sense.

We can justifiably suppose that the individuals holding shares in these giant corporations hold a broad spectrum of opinions, and corporate political contributors can hardly honor them all. Past experience also suggests that corporate managers are likely to try to shape government policy in a way that serves their own interests over that of their shareholders. (For example, managers have opposed most attempts to limit executive compensation.)

Common sense and experience also suggest that, given the enormous revenues of today's giant corporations, these companies will make their political contributions generously. (Disclosure might help allay this generosity somewhat.) The tenet that "nothing seems expensive when you can pay for it with other people's money" comes to mind.

Those investors who share my concerns aren't powerless against the Supreme Court's decision. Their first order of business is the submission of a resolution such as this for inclusion in the next proxy statement for each corporation in which they've invested:



RESOLVED: that the corporation shall make no political contributions without the approval of the holders of at least 75% of its shares outstanding.

I recommend a supermajority requirement because of the inevitably wide range of views in any shareholder base. As it happens, 75% is halfway between a simple majority and the standard (under Delaware corporate law) requiring a unanimous shareholder vote to ratify a gift of corporate assets.

Such a check on unfettered political contributions is essential now that our corporations are no longer controlled by "persons" (i.e., individual shareholders). Some 70% of the shares of big publicly held corporations are held by "agents"—the institutional investors who manage our mutual funds, pension funds, insurance and trust companies, and endowment funds.

These agents—who together hold working control of Corporate America—have all too often failed to honor their responsibilities of corporate stewardship, and they actively vote their proxies far too rarely. The record, as far as I know, is bereft of a single proxy proposal submitted by a mutual fund or pension fund investor in opposition to a corporation's management. The temptation for agents to take advantage of their agency position for their own benefit is too great. Large institutional investors, for instance, routinely manage the retirement plans and thrift plan portfolios of the very corporations whose shares they own. As the saying goes: "There are only two types of clients we do not want to offend: actual and potential."

Most institutional money managers today are owned by giant U.S. and global financial conglomerates with their own shareholders. Of America's 40 largest, 23 are owned by conglomerates, 8 are publicly held, and only 9 remain privately owned. Money managers who share my fears about unlimited corporate contributions to politicians must enter the arena with clean hands. Before they stand up against political contributions by the companies whose shares are held in their portfolios, they must publicly pledge a no-political-contribution policy of their own. This may sound like a tall order, but it's the only avenue that presents itself for, in effect, overriding the Supreme Court's unwise decision. |BW|

John C. "Jack" Bogle is founder and former chief executive of Vanguard. His latest book is Common Sense on Mutual Funds, 10th Anniversary Edition.

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